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ABSTRACT

This audit report discusses the operation of the Enterprise Fund by Cerritos Community College District in California. In addition, the Cerritos College Foundation's conflict of interest policies, its relationship with the district, and its award of contracts for services was reviewed. It was found that the district needed improvement in its operation of the enterprise, which consists of a bookstore, cafeteria, convenience store, grill, cosmetology services, and vending operations. Much of the focus of the examination of the Fund was on the management of the bookstore. The bookstore's assets represented 92% of the enterprise's total assets as of December 31, 1996. The cafeteria and convenience store in particular generally had negative balances large enough to create a negative balance for the whole enterprise. The district plans to resolve the bookstore's operating problems by privatizing it. However, without the revenues generated by the bookstore, the remaining elements of the enterprise would have even more significant cash flow problems. The cafeteria has had negative cash balances ranging from $63,161 to $113,733, while the convenience store has had negative cash balances ranging from $68,316 to $118,356. In the past, those negative balances have been subsidized by the bookstore. The report recommends that the district take steps to improve its accounting for and control over bookstore operations. (NB)

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Cerritos Community College:

Improvements Needed in Aspects of Operating the District and Its Auxiliary Organization

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October 27, 1997 96118

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report regarding the Cerritos Community College District (district), its operation of the Enterprise Fund (enterprise), the district's relationship with the Cerritos College Foundation (foundation), and its administration of various programs and activities.

This report concludes that the district needs improvement in its operation of the enterprise. Furthermore, the foundation needs to more closely mirror its organization to that of other college auxiliary organizations, it needs to adhere to its own procedures for electing directors to the foundation board, and it needs to follow state regulations for reimbursing the district when district personnel work on foundation business. This report also addresses other concerns about the management of the college that had been voiced by community members, but where we found no evidence that problems existed.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Cerritos Community College:

Improvements Needed in Aspects of Operating the District and Its Auxiliary Organization

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Summary

Audit Highlights . . .

We reviewed certain activities at Cerritos Community College. For most we found no evidence of mismanagement. However, we found weaknesses related to the college enterprise fund and the college foundation. Specifically:

- ☑ ***The bookstore has excessive credit balances from publishers because it does not aggressively pursue monies due to it.***
- ☑ ***Although the bookstore, cafeteria and convenience store all operate at a loss, the bookstore's fund balance reserves have subsidized these operations.***
- ☑ ***The foundation gives the college president authority exceeding that of other colleges surveyed.***
- ☑ ***The foundation does not follow all rules and regulations relating to appointment of its directors and reimbursement for district support.***

Results in Brief

Cerritos Community College District (district) was established on June 10, 1955 and consists of one community college campus. The district's mission is to provide high-quality, academic instruction in a curriculum respective of the diversity of its student body. The district provides an education in which students pursue a variety of educational goals, such as attaining an associate's degree, vocational degree or certificate, enhancing job skills, or transferring to a four-year university.

Numerous concerns have been voiced by members of the Cerritos College community about the administration of various programs and activities. To address these concerns, we reviewed each of the various programs or activities in question. We examined the district's Enterprise Fund (enterprise), with much of the focus on the management of the bookstore. In addition, we reviewed the Cerritos College Foundation's (foundation) conflict-of-interest policies, its relationship with the district, and its award of contracts for services. We also investigated an alleged lack of budgetary control over a $1 million dollar amount in the fiscal year 1994-95 line item for the president's office. Furthermore, we reviewed the district's policies for shared governance to determine if they follow the Chancellor's Office guidelines. We also reviewed the district's compliance with Section 58050 of the California Code of Regulations in claiming general state apportionment. In addition, we investigated the district's use of basic skills, matriculation, and Title III grant funds.

As we discuss more fully in the Appendix to this report, for many of the activities we reviewed, we found no evidence that Cerritos College had improperly managed the activity. For example, the $1 million item that was allegedly included in the president's budget was actually $675,000 and was included in a budget area designated for planning priorities. Additionally, this amount was subsequently allocated for the support of other campus activities, including computer labs for Instructional Services, and to pay hourly employees filling vacancies in Student Services and Business Services. Similarly, we found that the district generally followed the Chancellor's Office guidelines outlining the concepts of shared governance.

Furthermore, after reviewing a previous audit conducted of the district's process for claiming its state apportionment, we again found no evidence of impropriety. Finally, we concluded that the funds for matriculation, basic skills, and the Title III grant were also used appropriately.

However, we did find certain weaknesses related to the district's enterprise, its college foundation, and the filing of annual statements of economic interest, as outlined below:

- The district's enterprise has cash flow problems stemming mainly from the way the bookstore is operated. For example, the bookstore ineffectively manages thousands of dollars owed from book publishers. In addition, the bookstore has compounded its cash flow problems with several questionable donations and sponsorships.

- The bookstore's management of its book buyback process is ineffective and results in reduced profits and higher book costs for students.

- The foundation's structure allows the president of the college to exert greater influence over foundation operations than presidents of other community colleges that we surveyed.

- The foundation does not adhere to its own bylaws for electing new directors to the board. Rather than electing new directors by formal vote, the foundation uses an informal method of selection.

- Contrary to state regulations and its bylaws, the foundation has not reimbursed the district for the payroll costs of district personnel that perform foundation work.

- Some employees are required by the district's conflict-of-interest code to file annual statements of economic interest; however, better disclosure is needed from individuals required to file these statements in reporting outside income and business interests.

Recommendations

To address the weaknesses in the operation of the bookstore, the district should take the following steps:

- Reduce the amounts paid to book publishers by the amount of receivables (debit and credit memos) owed from those publishers.

- Obtain future book requisitions from instructors during the prior semester to better forecast the bookstore's needs for new books and to better manage its used book buybacks.

To more closely mirror other college auxiliary organizations and adhere to its own procedures and state regulations, the foundation should take the following steps:

- Revise the bylaws so that no one person, including the college president, has the authority to select directors without a vote or make the final decision over foundation activities.

- Follow its policies regarding admitting new directors to the board. As specified in the foundation bylaws, the membership committee should submit names of potential directors to the full board for a vote of approval.

- Repay the district for payroll costs incurred by the district during fiscal years 1994-95 and 1995-96 as a result of district personnel performing work for the foundation. In addition, the district should maintain accurate records of all work performed by district personnel on foundation business and periodically seek reimbursement from the foundation.

To guard against potential conflicts, the district should take the following step:

- Provide adequate instructions to those individuals holding district positions designated as required to file annual statements of economic interest on how to complete these statements.

District Comments

Our report makes 15 recommendations that we feel will improve operations of the district's enterprise and foundation, and will provide better disclosure of economic interests by its designated employees. In its response, the district agrees with all but four of our recommendations. Specifically, the district disagrees with two of our recommendations regarding its use of district employees on foundation activities without seeking reimbursement. Also, the district does not agree that the bylaws for the operation of its foundation should be changed so that no one person, including the president, has the authority to select directors without a vote or make the final decision over foundation activities. Finally, the district disagrees with our recommendation that the foundation's board approve and monitor all foundation events and projects. The district contends that the event in question was really a college event and not a foundation event.

Introduction

Background

Cerritos Community College District (district) was established on June 10, 1955. The district consists of one community college campus located in Norwalk, California, which serves the communities of Artesia, Bellflower, Cerritos, Downey, Hawaiian Gardens, Lakewood, La Mirada, and Norwalk. The district has an enrollment of approximately 20,000 students.

The district is governed by a seven-member Board of Trustees (board) elected by district voters. The board holds at least two regularly scheduled meetings each month to carry out its responsibilities. The district president, who is also the college president, is responsible for executing all decisions of the board and operating the district in accordance with the board's policies.

The district collects much of its base revenue through state general apportionment (state apportionment) and tuition. State apportionment represents approximately 38 percent of base revenue, with tuition making up approximately 7 percent. The remainder of the district's funding is made up of approximately 3 percent federal; 8 percent state, excluding state apportionment; and 44 percent local, excluding tuition fees.

Each year the Chancellor's Office apportions state aid, in accordance with the Education Code, based primarily on the number of full-time equivalent students (FTES) the district reports. One FTES represents a student who attends community college courses three hours per day for one academic year. The Chancellor's Office uses the number of FTES reported by the district to calculate the state apportionment funding the district will receive up to a preestablished level. The district is eligible for supplemental funds if enrollment exceeds the number of FTES for the preestablished level. When the district is eligible for these funds, the Chancellor's Office uses the district's excess FTES to calculate the supplemental funding it will receive.

The district's revenue also includes categorical funds for matriculation and federal funds for a Title III grant. The matriculation program helps students reach their educational goals by tailoring support services to their needs. Permissible uses of state matriculation funds include assisting

students with college applications; providing assessment tests and orientation; advising students about their curricula; and researching, evaluating, and processing matriculation data. Funds for matriculation are allocated by the Chancellor's Office as prescribed by law.

Title III of the Higher Education Act is a federal grant to assist the district in providing low-income and minority students access to a quality education. The grant funds may be used by instructors to obtain advanced degrees to enhance the education they give their students; to purchase library books, periodicals, microfilm, and other educational materials; to provide tutoring, counseling, and other student service programs that improve academic success; and to provide funding for administrative costs. Finally, Title III funds can be used to acquire computers or other equipment so the district can fulfill the grant's purpose.

The district also operates an Enterprise Fund (enterprise) to provide goods and services for the general benefit of staff and students. At Cerritos, the enterprise operates a bookstore, a cafeteria, a convenience store, a grill, vending operations, and cosmetology services. The district intends that these activities be self-supporting.

In addition, the district has an auxiliary organization called the Cerritos College Foundation (foundation). The foundation was formed as a nonprofit organization in 1979 to provide a private support system for the college. Governed by a board of directors that includes the president of the college, members of the district board of trustees, faculty members of the college, and members of the community, the foundation's primary goals include providing funds to the college for improvements to campus facilities and providing students short-term financial assistance and scholarships.

Scope and Methodology

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of the district. Specifically, we were asked to address alleged violations of state policies and procedures in budgeting, planning, and expenditures for programs and projects; contracting; and potential conflicts of interest.

To understand the district's responsibilities and operations, we reviewed the laws, regulations, and policies relevant to the district in general and to the audit request in particular. We also assessed the financial position of the district's enterprise,

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with primary emphasis on the bookstore. In addition, we evaluated the foundation's relationship with the district and its recording of revenues and expenditures. We also reviewed both the district's and foundation's policies and procedures regarding conflicts of interest and contracting.

To assess the enterprise's financial position and determine the nature of various account balances, we first interviewed district staff. We also reviewed documentation supporting these accounts. In addition, we interviewed district staff to determine its procedures for recording transactions and preparing financial statements. Furthermore, we reviewed the district's and the enterprise's audited financial statements and interviewed the external auditors to understand their procedures for testing certain account balances. To compare the bookstore's financial practices and operations with accepted bookstore procedures, we surveyed five other college bookstores. Finally, we reviewed the enterprise's internal controls over purchases and sales and tested those controls to determine their effectiveness.

To ascertain whether district employees performed unreimbursed work for the foundation, we first interviewed district staff. Then, for those district employees who did work for the foundation, we reviewed time sheets or requested estimates of time spent working for the foundation. We also reviewed the foundation's revenue and expenditure reports to determine if it reimbursed the district for these services and to ascertain whether any unusual fund transfers occurred between the foundation and the district. Finally, to determine whether it is customary practice for districts to supply employees to work for auxiliary organizations without reimbursement, we surveyed five other community colleges. To compare the role of Cerritos's president in the operations of its foundation to the roles of other community college presidents, we reviewed the bylaws and implementing regulations of five other community college foundations.

Also, to determine whether the foundation had developed any policies or procedures regarding conflicts of interest, we interviewed district staff. We also evaluated the adequacy of the foundation's conflict-of-interest practices. In addition, we reviewed the foundation's board of directors' minutes to determine whether concerns had been expressed about conflicts of interest among board members but found no such instances. Furthermore, to determine that the

foundation awarded and managed its contracts in accordance with sound business practices, we reviewed its contracting process.

To confirm whether any conflicts of interest existed within the district, we reviewed its policies and procedures regarding conflicts of interest. We then reviewed copies of the designated employees' annual "statement of economic interest" forms to determine whether those employees the district required to file statements had in fact done so. In addition, we reviewed district board minutes to identify any concerns raised regarding conflicts with respect to budget, contract, or spending decisions made by designated employees. However, nothing came to our attention to indicate such conflicts were present. We also assessed whether all such decisions were made within the board's authority and were consistent with the district's conflict-of-interest policy.

To assess whether the district complied with its contracting practices, we interviewed district staff to understand the policies and procedures for entering into contracts. We also reviewed 30 of the district's contracts to determine the scope of work performed and to ascertain whether the district had adhered to applicable laws, policies, and procedures. To determine that the district's board of trustees properly approved payment for outside legal services, we examined the monthly legal billings for fiscal years 1995-96 and 1996-97 and the process for approving them. This examination included both regular billings from the district's counsel and billings from third-party contractors engaged by the counsel on the district's behalf.

Finally, to address the concerns raised by critics about the district's handling of deliberations on policy issues; reporting of attendance to obtain state apportionment; and its use of basic skills, matriculation, and Title III funds, we investigated the allegations but were unable to substantiate them. The Appendix details our review and conclusions regarding the allegations.

Chapter 1

The District Has Not Effectively Managed the Operations of the Enterprise Fund

Chapter Summary

The Cerritos Community College District's (district) Enterprise Fund (enterprise) has cash flow problems stemming mainly from the way the bookstore is run. The bookstore is the largest component of the enterprise; therefore, we concentrated our efforts on its operations. The bookstore ineffectively manages thousands of dollars owed from book publishers, inaccurately values its inventory, overstates the amounts owed to vendors, and poorly manages its book buyback program, resulting in lost sales and lower profits. In addition, the bookstore has compounded its cash flow problems with several questionable donations and sponsorships. To take control of this situation, the district is considering privatizing the bookstore, and an advisory committee is currently evaluating bids from private companies interested in operating the bookstore.

The district itself has contributed to the enterprise's cash flow problems as well because it did not promptly reimburse the enterprise for interest earnings, funds the enterprise needed to ease its cash flow problems.

Background

The district operates an enterprise fund that provides goods and services for the general benefit of the district. The enterprise is composed of a bookstore, cafeteria, cosmetology services, convenience store, grill, and vending operations; with the bookstore's assets representing 92 percent of the enterprise's total assets as of December 31, 1996. To assess the financial position of the district's enterprise fund, we reviewed the district's audited financial statements for the last three fiscal years, as well as that of the enterprise for the calendar year ended December 31, 1996. The district's Board of Trustees (board) engaged an external audit firm to conduct a special

audit of the enterprise operations for calendar year 1996. As shown in Table 1, we found that over the last three years several of the enterprise's component businesses have suffered losses and experienced cash flow problems.

Table 1

Financial Trends for Enterprise Components
July 1, 1993 To December 31, 1996

Description	Bookstore	Cafeteria	Cosmetology	Vending	Convenience Store	[1]Total Enterprise
Cash Balance (Deficit) at:						
June 30, 1994	$394,465	($ 78,524)	$ 66,080	$ 45,260	($ 96,542)	$330,739
June 30, 1995	$232,935	($113,733)	$ 59,006	$ 41,523	($118,356)	$101,375
June 30, 1996	$238,672	($ 63,161)	$ 60,817	$ 18,199	($ 91,951)	$162,576
December 31, 1996	$ 41,985	$ 7,819	$ 61,941	$ 22,828	($ 68,316)	$ 66,257
Net Income (Loss):						
Fiscal Year 1993-94	($202,337)	($ 32,061)	$ 9,582	($ 1,151)	($ 30,286)	($256,253)
Fiscal Year 1994-95	$ 65,381	($ 25,403)	($ 8,460)	($ 395)	($ 21,967)	$ 9,156
Fiscal Year 1995-96	$ 36,510	($ 29,318)	($ 859)	($ 8,944)	($ 2,842)	($ 5,453)
Calendar Year 1996	($475,762)	$ 20,101	$ 13,293	$ 4,896	$ 41,868	($395,604)
Retained Earnings * at:						
June 30, 1994	$1,054,816	($ 96,720)	$ 87,497	$ 39,346	($123,225)	$961,714
June 30, 1995	$1,101,138	($125,367)	$ 79,087	$ 38,720	($145,329)	$948,249
June 30, 1996	$1,004,201	($155,368)	$ 76,695	$ 28,422	($146,210)	$807,740
December 31, 1996	$ 506,837	($180,105)	$ 61,735	$ 28,895	($136,572)	$280,790

*Retained earnings represent the net worth of an entity (i.e., assets minus liabilities equals retained earnings).
[1] The grill began business on January 1, 1997; therefore, its operations are not shown in this table.

Although the bookstore has sustained significant losses in past years, it has still performed better in terms of its cash balance than the other enterprise components. The cafeteria and convenience store in particular have generally had negative cash balances large enough to create a negative cash balance for the entire enterprise for fiscal years 1993-94 through 1995-96 if the cash balance of the bookstore were removed.

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The Bookstore Maintains an Excessive Balance of Receivables From Publishers

The college bookstore industry refers to receivables from publishers as debit and credit memos. Debit memos are internally generated when the bookstore returns overstocked books to publishers and expects to receive a credit. When the publisher receives returned books, it sends the bookstore a credit memo that confirms the credit for the value of the books. This credit can be applied against future purchases from the publisher.

Table 2

Information Regarding College Bookstores Surveyed

	Cerritos Community College	Glendale Community College	Sacramento City College	Long Beach City College	California State University, Sacramento	California State University, San Diego
Number of full-time students	14,301	11,156	13,034	16,872	23,420	29,981
Annual gross sales for fiscal year ended June 30, 1997	$3.0 million[a]	$3.1 million	$2.3 million[b]	$3.9 million	$9.9 million	$18.8 million
Inventory balance at June 30, 1997	$659,000	$792,000	$700,000[b]	$1 million	$1.9 million	$3 million

[a] The most recent information available regarding Cerritos bookstore's gross sales is for the period July 1, 1996 through March 31, 1997.
[b] This information is for the fiscal year ended April 30, 1997.

As of August 18, 1997, the bookstore had a balance of debit and credit memos of $214,000 and $404,000, respectively, for a combined balance of $618,000. Of this balance, 54 percent of the debit and 22 percent of the credit memos were six or more months old. As shown in Table 2, we surveyed five other college bookstores, including three that are comparable in their number of full-time students, annual gross sales, and inventory balances. Our survey revealed that the average combined balances of debit and credit memos reported by the other bookstores were significantly lower than the Cerritos's bookstore. The bookstore's large balance of receivables due from publishers, combined with their age, raises serious concerns about their collectibility and contributes to the enterprise's cash flow problems.

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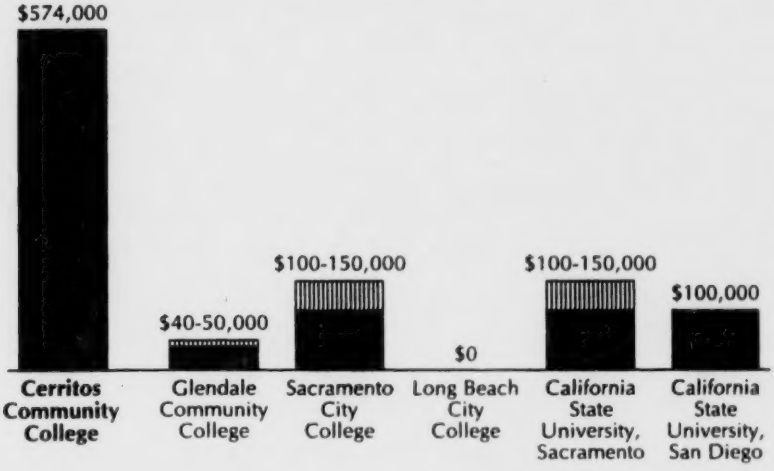
Figure 1

Average Combined Balance of Debit and Credit Memos



Cerritos bookstore's large receivables balance is partially the result of purchasing more textbooks than needed.

As depicted in Figure 1, Cerritos bookstore's combined debit and credit balance averaged more than three times the average reported by the Sacramento City College and the two California State University bookstores surveyed, even though the two university bookstores dwarfed Cerritos in terms of annual gross sales and inventory balance. Moreover, Cerritos bookstore's combined debit and credit balance averaged more than 11 times the average reported by Glendale Community College. Long Beach City College reported it did not carry any debit or credit memo balances at all because it immediately applies these balances against vendor purchases, thereby avoiding carrying any debit or credit memos. The Sacramento City College bookstore reported that while its combined balance of debit and credit memos generally averages between $100,000 and $150,000, at certain times this balance peaks as high as $300,000 to $500,000. Unlike the Cerritos bookstore, however, the Sacramento City College bookstore reported that only 10 percent of these debit and credit memos are six months old.

The Cerritos bookstore's large balances of debit and credit memos are partially the result of purchasing more inventory than needed. For example, when the bookstore overstocks its textbook inventory, the excess books must be returned to the publisher, which causes the bookstore to generate an internal debit memo. The publisher issues a credit to apply against future purchases when it receives the returns.

As previously stated, the bookstore's balance of debit memos was $214,000 as of August 18, 1997, with 54 percent six or more months old. The bookstore still has not received corresponding credit memos, totaling $63,000, from 33 of 52 (63.5 percent) of these vendors, raising serious concerns about the collectibility of these debit memos.

Unlike the other bookstores surveyed, Cerritos does not apply its debit and credit memos against unpaid invoices on hand.

We also noted that the bookstore does not apply its debit and credit memos against purchase invoices payable to corresponding vendors. For example, we noted that the bookstore was holding combined debit and credit memos of $89,000 for a large publisher. However, at the same time it was also holding $89,000 in invoices it had not yet paid the same publisher. By not applying the debit and credit memos against current invoices, the bookstore is not ensuring prompt collection on returned merchandise and is overstating both its accounts payable and the value of its debit and credit memos. Consequently, at any given time, the enterprise does not have accurate information on the bookstore's true accounts payable balance or the amount of its net debit and credit memos. Moreover, by failing to apply debit and credit memos against unpaid vendor invoices, the bookstore is not optimizing its cash flow. For example, if the bookstore pays the $89,000 invoiced rather than eliminating the amount by applying its debit and credit memos, it is unnecessarily reducing its cash balances and not ensuring the collection of these outstanding balances.

When we first discussed this problem with the business services officer, she acknowledged that business services was not applying debit and credit memos against outstanding invoices. She further stated that she would ensure that debit and credit memos are applied against outstanding invoices in the future.

Based on the results of our survey of other college bookstores, we found that three bookstores apply their debit memos against any unpaid invoices on hand even before receiving corresponding credit memos from the vendors. Additionally, to the extent these bookstores receive credit memos from vendors, they do not wait as Cerritos does to apply them to future purchases. Rather, these bookstores immediately apply credit memos against any corresponding unpaid invoices on hand. These strategies help to minimize their credit balances with vendors and make better use of their cash balances. Because Cerritos's bookstore does not use these strategies, it is not effectively minimizing its credit balances with vendors and maximizing its cash flow.

According to the college bookstores we surveyed, in some instances publishers will issue cash refunds for credits. However, we noted that Cerritos's bookstore does not

The bookstore also does not consistently attempt to obtain cash refunds for credit memos issued by publishers.

consistently attempt to obtain refunds for credit memos, including credits from vendors it no longer does business with. This is another factor contributing to the large balance of credit memos the bookstore carries. When the bookstore fails to vigorously pursue cash refunds for these credits, it loses money needlessly. According to the business services officer, a temporary employee was hired to send letters to various publishers requesting refunds for credit memos. The temporary employee worked on this project from April 1996 through December 1996, and generated refunds of approximately $114,000 to the bookstore. Therefore, it appears that it is possible for the bookstore to obtain significant refunds for credit memos when a continuous attempt is made. However, from January through June 1997, after the temporary employee was no longer working for the district, only $17,000 of refunds for bookstore credit memos were collected.

According to the business services officer, the business office is attempting to improve its collections by sending a letter to request refunds from vendors for credit memos. It is anticipated that letters will be sent to vendors by the end of October 1997. Additionally, the business services officer stated that she intends to use a collection agency to pursue refunds from those vendors who do not respond to the letter. The district has already entered into an agreement with a collection agency for this purpose. Finally, in the event the district is still unsuccessful in obtaining refunds, it may pursue legal action through its district counsel.

Once credit balances become stale, or the college discontinues business with a vendor, it is less likely that the credit balance will ultimately be collected. However, business services should not consider writing these amounts off until it exhausts all available actions for obtaining refunds.

The Textbook Buyback Process Is Ineffective

The bookstore is not managing its book buyback program as well as it could because it does not have a system for obtaining timely information from instructors about the books needed for the following semester. Such information is critical in determining which books and how many will be needed in the following semester. Specifically, the bookstore does not always obtain book order information in time to buy back used books from students before placing new textbook orders.

The bookstore does not require the instructors to provide the book lists for the upcoming semester in time to buy back used books from students before placing new textbook orders.

The bookstore currently buys used books back from students at the beginning and end of every session. However, the largest single book buyback occurs at the beginning of the fall semester because the bookstore receives textbook requisitions from instructors for the fall semester after the completion of the spring semester. As a result, the bookstore does not know which books instructors will require prior to the spring student buyback in the middle of May. Therefore, the bookstore only buys those books it is certain it will need in the following semester.

The bookstore may buy books that it knows will be used for several semesters. However, according to the bookstore's interim manager, the bookstore does not buy back many used books without first receiving a textbook requisition confirming that the book will actually be used in the following semester. Consequently, the buyback at the end of the spring semester is significantly smaller than the buyback that occurs at the beginning of the fall semester, when the bookstore has received the textbook requisitions and is certain of which books are needed.

The current process has several undesirable consequences. For example, rather than buying back most books from students immediately following class completion, the major book buyback occurs at the beginning of the following semester. This may cause the bookstore to purchase more new textbooks than it actually needs to meet student demand because it has not yet bought back all available used books and cannot predict the number that students will sell. Therefore, the bookstore cannot fully take advantage of this stock of used books to reduce the quantities of new books it purchases for each fall semester. In our survey of other college bookstores, we found that all five establish deadlines for receiving instructors' book orders in time to schedule book buybacks at the end of each semester.

Moreover, because of the inopportune timing of Cerritos's major book buyback, many students may be forced tc buy more expensive new books rather than less expensive used books. Additionally, students selling their books back at semester's end may receive less money because if the bookstore is not yet sure that it will need a particular book the following semester, students will only receive the wholesale price. Typically, this is much less than the 50 percent of retail paid for books the bookstore intends to use again.

The book buyback process results in fewer used book sales and reduced profitability.

Furthermore, the later the bookstore receives book order information, the less chance it has of being able to purchase used texts from book companies. These used texts are in limited supply and are quickly bought by other college bookstores that identify their needs sooner. Therefore, the bookstore must purchase a higher proportion of new textbooks and pass on the higher overall book costs to students.

Finally, the bookstore's current process results in reduced used book sales, which in turn may be reducing the bookstore's profitability. The gross margin, the difference between a book's sales price and its cost, is higher on used textbooks; Cerritos bookstore's gross margin is 33 percent on used books compared to a 28 percent gross margin on new textbooks. Not only does selling more new books than necessary ultimately reduce profits, it may lead to excessive inventory purchases, resulting in large numbers of subsequent returns to publishers. These returns translate into more debit and credit memos, further exacerbating the enterprise's cash flow problems.

The Bookstore's Inventory Valuation Method Does Not Meet Accounting Standards

The bookstore conducted a physical count of its inventory as of June 30, 1997. This inventory count was observed by the district's external auditors as part of its year-end audit. Because the external auditors performed test counts of the bookstore's inventory, we did not verify the accuracy of inventory counts. However, on a sample basis, we did test the cost data the enterprise uses to value the textbook inventory and found that the method the enterprise uses is not in accordance with generally accepted accounting principles (GAAP).

The bookstore values its new textbooks at the cost of its most recent shipment, including any of these same books it may have on hand previously purchased at lower prices. As a result, any time the bookstore receives new textbooks at a per-unit cost higher than that of those same textbooks already included in its inventory, the bookstore overstates both the value of its inventory on the balance sheet and its cost of goods sold on the income statement. Similarly, it values used books not at historical cost; that is, the original amount paid, but as a percentage of the retail price of new textbooks. According to

the bookstore's interim manager, all used textbooks are valued at 50 percent of the retail price of an equivalent new textbook. This valuation method also overstates the true cost of used textbooks.

Several valuation methods exist that conform with GAAP including using the average cost of items to value inventory or using a method that assigns value to the inventory by layer of purchase cost, such as first-in/first-out or last-in/first-out. However, there is no acceptable valuation method that allows the "replacement" of an existing inventory cost with a different cost, such as the valuation method used by the enterprise.

The current valuation method overstates both the value of the inventory and the related cost of goods sold.

We selected a sample of 20 textbooks (14 new and 6 used) and traced the cost data per the inventory records back to actual invoices. We noted that 11 (55 percent) of these books were not valued at their true costs. Of the 14 new textbooks, 5 were not valued at historical cost. Four texts were overvalued based on the cost of the most recent receipt of these books, and one was valued at a cost lower than its historical cost. Furthermore, all six of the used textbooks were valued at costs exceeding their historical costs.

According to its interim manager, the bookstore values textbooks in the manner described above because of the limitations of the bookstore's Point of Sale (POS) computer system. The POS system will accept only one cost for each textbook. It will not allow the bookstore to include layers of cost data for each textbook. However, in spite of these limitations, the bookstore could manually calculate an average cost based on the average of the most recent book's cost and the cost of those books already in stock. The bookstore could then enter this average into the POS system as necessary, resulting in a closer approximation of the true value of any given textbook while conforming with GAAP.

For example, if the bookstore has 100 new textbooks in stock, and half cost $25 each while half were purchased later at a cost of $30 each, the system will accept only one cost. Due to this system constraint, the bookstore uses the cost of the most recent shipment to represent the per-item cost of the book's entire inventory. In this case, all 100 books would be valued at $30 each and the value of the inventory for this book would be overstated. As shown in Table 3, however, if the bookstore would manually enter an average cost into the POS system, the value of the inventory would not be overstated.

Table 3

A Comparison of Actual, Average, and Most Recent Textbook Cost

Actual Cost of Inventory	Average Cost of Inventory	Cost Based on Most Recent Invoice
$25 cost $30 cost x 50 books x 50 books $1,250 $1,500 **Total cost: $2,750**	$27.50 cost x 100 books $2,750 **Total cost: $2,750**	$30 cost x 100 books $3,000 **Total Cost: $3,000**

Similarly, although the bookstore buys back some used books from students at 50 percent of the retail price of an equivalent new book, it purchases others from used book companies at costs we found to be generally lower than 50 percent of retail. However, due to the constraints of the POS system, the bookstore assigns values to all used books at 50 percent of the retail price of an equivalent new book, regardless of their true cost.

Because the enterprise does not value the bookstore's textbook inventory based on a method complying with GAAP, neither the bookstore nor users of its financial statements have accurate information regarding the value of the bookstore's inventory or its actual cost of goods sold. Additionally, based on the results of our testing, it appears that the valuation method the enterprise uses generally results in overstatements of the bookstore's inventory on the balance sheet and of the cost of goods sold on the income statement.

Inflating the historical cost of some textbooks results in a markup higher than intended.

Inflating the historical cost of some textbooks results in a markup of those books that is higher than it should be. Assuming that the bookstore marks up its textbooks based on the cost presented in the POS system, the effective markup would be actually higher than the bookstore's stated 28 percent and 33 percent gross margin on new and used textbooks. This additional cost is either passed on to students in the form of a higher retail selling price or results in lost sales as students turn to off-campus bookstores.

The college bookstores we surveyed reported standard markup percentages ranging from 25 percent to 27 percent for new textbooks, with three of the colleges reporting standard markups of 26 percent. Therefore, regardless of the effect of the inflated cost information, Cerritos bookstore's standard markup for new textbooks is higher than other college bookstores. According to the interim manager, this is partially because the bookstore is contractually bound to pay a commission to the associated student body of 5 percent of the bookstore's gross sales. The district has considered reducing the markup to 26 percent, but the student body does not want its commission reduced.

Despite its poor financial condition, the bookstore contributed $3,000 cash, spent $1,400 on a tea and dinner, and wrote off $3,700 in promotional merchandise for foundation events.

Bookstore Sponsorships and Donations to the Foundation Appear Imprudent in Light of Cash Flow Problems

The bookstore was a corporate sponsor of the Cerritos College Foundation's (foundation) annual golf tournament for the last two fiscal years, contributing $1,500 each year. Further, in fiscal year 1994-95, the bookstore also contributed $1,400 for a foundation tea and dinner. Finally, during fiscal year 1995-96, approximately $4,700 of promotional merchandise, such as coffee cups, water bottles, and lapel pins, were purchased by the bookstore for sale at a foundation event, but most of these items did not sell. All but $1,000 of the unsold merchandise was charged to the bookstore's advertising account or written off against its inventory account; however, the foundation partially shared this loss because it reimbursed the bookstore for $1,000. Nevertheless, these sponsorships and donations were not prudent given the bookstore's—and the rest of the enterprise's—cash flow problems. According to the college president, the bookstore is no longer making donations to the foundation or sponsoring its events.

The Bookstore Overstates Its Accounts Payable Balance

During our review, we found that the bookstore overstates its accounts payable balance by including encumbrances for goods and services not yet received, although a consultant had previously recommended against this practice. An encumbrance is a legal obligation to purchase goods or services, as opposed to those that have been received but not yet paid for. For example, an executed contract is a legal obligation even though no goods and services may yet have been received. Conversely, for a contract where goods or services have been received but not yet paid for, only the

The bookstore overstated its accounts payable balance by 75 percent or almost $1 million.

invoiced amounts represent accounts payable. According to accounting standards, the enterprise should only include amounts representing goods and services received, but not yet paid for, as accounts payable. The enterprise's accounts payable balance should not include encumbered purchases; however, we noted that of the nearly $1.3 million accounts payable balance at March 31, 1997, approximately $939,000 (75 percent) represented encumbered purchases. Furthermore, we noted that the district overstated its encumbrance balance by $39,000 because it inadvertently encumbered the same purchase order twice, which has since been corrected. When we discussed this issue with the business services officer, she stated that as of the quarter ended June 30, 1997, encumbered purchases are no longer included in the bookstore's accounts payable balance.

The Bookstore's Internal Controls Over Cash Are Inadequate

Cerritos's bookstore cashiers do not count their cash or reconcile it to the daily sales receipts at the end of each day before relinquishing control of their cash drawers. Currently, at the end of the day, each cashier turns over his or her cash drawer to a supervisor who then locks it up in the vault. The following morning, a bookstore clerk counts each cash drawer and balances it to the sales report from the previous day. The accounting supervisor keeps a record of any cash overages or shortages. However, this practice does not provide adequate accountability or internal control over cash and may lead to unnecessary losses.

A better process would have each cashier count his or her own cash and reconcile that amount to the day's sales before turning over the cash drawer. This would ensure a clear line of accountability for each cash drawer. Once a cashier reconciles his or her cash to the day's sales and receives a supervisor's approval, the cashier is no longer responsible for the drawer. Therefore, if there are any overages or shortages, it is easier to determine who is responsible. Currently, if there is an overage or shortage, it is difficult to determine who is at fault because there is no line drawn to clarify when the cashier's responsibility for the cash ends and another district employee's responsibility begins.

Privatizing the Bookstore May Negatively Affect the Enterprise's Other Entities

The district plans to resolve the bookstore's operating problems by privatizing it. On July 8, 1997, the district issued a request for proposal (RFP), soliciting bids from entities interested in operating the bookstore. Three parties responded to the RFP, and the district established an advisory committee to evaluate the bids. As of October 8, 1997, the advisory committee was still in the process of considering this matter.

The advisory committee has completed its evaluation of the written bids, but has yet to perform site checks at bookstores the bidders currently operate and check the bidders' references. Because the RFP allows bidders to negotiate its terms, the advisory committee will then begin negotiations. At that point, the committee will decide whether the bookstore should be privatized. If the advisory committee decides in favor of privatization, it will make this recommendation to the district board. Additionally, the advisory committee will recommend which bid should be accepted and may rank the three bidders. The board will make the final decision whether to privatize.

Without revenues generated by the bookstore, the remaining entities of the enterprise face a more significant cash flow problem than now exists.

At this time, it is still unclear whether the bookstore will ultimately be privatized. The advisory committee anticipates making its recommendation to the board in November 1997. If the bookstore is privatized and the terms of the original request for proposal are accepted, some of the bookstore's operating problems may be resolved. However, even if the bookstore is privatized, there are issues the district will still need to address.

For example, without the revenues generated by the bookstore, the remaining elements of the enterprise would have even more significant cash flow problems. Additionally, if the operating trends for these remaining elements continue, we have serious concerns regarding the enterprise's continued financial viability. As shown previously in Table 1, the cafeteria and the convenience store have generally had negative cash balances for the last three years. The cafeteria had negative cash balances ranging from $63,161 to $113,733, while the convenience store's negative cash balances ranged from $68,316 to $118,356. In the past, these negative balances have been subsidized by the bookstore. However, these other components' negative cash balances are large enough that if the bookstore's cash were removed, the entire enterprise would have a negative cash balance.

Furthermore, although the bookstore has sustained significant losses in past years, it has still performed better than many of the other enterprise components and has had a significant fund reserve to fall back on. For example, although it lost $202,337 and $475,762 in fiscal year 1993-94 and calendar year 1996, respectively, the bookstore's retained earnings balance could absorb these losses. On the other hand, the losses the cafeteria and convenience store experienced each year from fiscal year 1993-94 through 1995-96 averaged a combined $47,000 a year, with both components having negative retained earnings balances. The overall enterprise retained earnings balance was $280,790 as of December 31, 1996, with the bookstore providing $506,837 of this balance. Therefore, if the bookstore were to be privatized, the entire enterprise would immediately have a deficit balance in its retained earnings of $226,047 as of that date.

Although the bookstore sustained significant losses in past years, the enterprise could fall back on its fund balance reserves, but if the bookstore is privatized its reserves will no longer be available.

We shared these concerns with the district president and asked if a plan had been developed to address them in the event the bookstore were to be privatized. Further, we asked how these concerns would be addressed in the event the bookstore was not privatized. According to the president, steps are being taken to resolve the cash flow problems of the remaining elements of the enterprise should the bookstore be privatized. He indicated that the cafeteria, which provides a laboratory experience to culinary arts students, is currently receiving its operating funding from the district and will continue to do so. As for the convenience store's cash flow problems, the president stated that one employee's theft of cash and merchandise has led to both the cash flow problems and past losses. As of September 17, 1997, the employee was terminated by the district's board. Regarding the future operations of the convenience store, the president stated that the district will explore the possibility of also privatizing this element of the enterprise.

To address the deficit fund balance in the enterprise if the bookstore were to be privatized, the president will recommend that the enterprise be viewed as a single financial entity rather than as component parts. Then, using the cash generated from the privatization, the district will pay off all enterprise liabilities owed to outside vendors and to the district. If insufficient cash is generated from the sale of the bookstore to pay these liabilities, the president stated that the commissions normally paid by the buyer of the bookstore to the associated students would instead be retained by the district until all liabilities are paid.

In the event the district is unsuccessful in its effort to privatize the bookstore, the president stated that the district will aggressively recruit for an experienced bookstore manager. Also, the bookstore would be redesigned to a "store-within-a-store" layout. The president believes that this change will allow a much smaller retail operation to function during off-peak business hours. Finally, the president stated that if the district continues to operate the bookstore, it will pursue developing a California consortium of community colleges to cooperatively buy textbooks.

Reimbursement of the Enterprise for Interest Earnings Was Delayed

The district was seven months late in paying the enterprise $38,000 in interest earnings.

The district was at least seven months late reimbursing the enterprise approximately $38,000 in net interest earnings on cash balances deposited with the Los Angeles County Treasurer from March 1994 through December 1995. The amount of interest earnings was net of bank and armored car charges incurred by the enterprise during this period. The district did not receive the information it needed from the Los Angeles County Office of Education (LACOE) to calculate this amount until calendar year 1996. As a result of this delay, the enterprise did not promptly receive funds it needed to ease its cash flow problems. According to a representative of LACOE, Cerritos was not the only district to receive this information late. However, LACOE is now starting to process and send this information to districts on a monthly basis. Therefore, the district should be able to reimburse the enterprise for net interest earnings on a more timely basis in the future.

After calculating the reimbursement, interest earnings are allocated among the enterprise's component businesses. However, during our testing, we noted that the process the enterprise uses to make this allocation is very labor-intensive, is based on a faulty calculation, and is not equitably distributed. District employees spend considerable time computing the allocation among the enterprise components, time that could be better spent performing higher priority activities, such as applying credit memos against billings from vendors. A fairly simple and more equitable method would be one based on the average monthly cash balances of the enterprise components on deposit with the county treasurer.

Conclusion

Over the last three years, the college's enterprise businesses—which include the bookstore, a cafeteria, cosmetology services, a convenience store, a grill, and vending operations—have, as a group, suffered losses and experienced cash flow problems. Our audit focused primarily on the college bookstore, where we identified weaknesses that, when addressed, should lead to improved cash flow and profitability. Our primary concern is that the bookstore carries an unusually high balance of receivables due from publishers, contributing to the bookstore's cash flow problems. Also, the bookstore is not managing its book buyback program in a manner that is best for the bookstore's profitability or for the students. The bookstore can address this weakness by obtaining, earlier in each semester, information from instructors about which textbooks will be used in the upcoming semester. Finally, the bookstore made imprudent donations to the college foundation in fiscal years 1994-95 through 1996-97.

Furthermore, we observed several accounting problems and one internal control weakness. The bookstore's current inventory valuation method can overstate the value of the inventory and the cost of goods sold. Similarly, the bookstore overstates its accounts payable balance by including encumbered purchases for goods and services not yet received. In addition, bookstore cashiers do not reconcile their cash to the daily sales receipts at the end of their shift before relinquishing control of their cash drawers.

Finally, we noted that the district contributed to the enterprise's cash flow problems as well. The district did not promptly reimburse the enterprise for interest earnings, funds the enterprise needed to ease its cash flow problems. To remedy its cash flow and profitability problems, the district is considering privatizing the bookstore.

Recommendations

To address the weaknesses that we have identified in the operation of the bookstore, the district should take the following steps:

- Reduce the amounts paid to book publishers by the amount of receivables owed (debit and credit memos) from those publishers.

- Implement a process to consistently attempt to obtain refunds for unmatched or older debit and credit memos from vendors. Delegate this responsibility to either business services or the bookstore, as appropriate.

- Obtain book requisitions from instructors during the prior semester for the upcoming term, so that the bookstore can better forecast its needs for new books and better manage its used book buybacks.

- Ensure that it receives information regarding the enterprise's net interest earnings from the Los Angeles County Office of Education on a monthly basis. Upon receiving this information, it should promptly reimburse the enterprise for interest earnings and allocate these reimbursements to the enterprise components using an equitable basis, such as the average monthly cash balances deposited by each component.

Finally, the district should take steps to improve its accounting for, and control over, bookstore operations by doing the following:

- Compute an average per-unit cost whenever new book shipments are received at a cost different from that of the same book already in the inventory when revaluing the bookstore's inventory for those books.

- Value the inventory of used books based on their average cost, rather than as a percentage of the retail price of an equivalent new book when used books are purchased from used book companies as well as students.

- Do not include the cost of goods and services that have yet to be received from vendors in the bookstore's accounts payable balance.

- Require that bookstore cashiers count their cash and reconcile that amount to the sales total at the end of each shift.

Chapter 2

The Foundation's Activities Appear to Be Heavily Influenced by the District

Chapter Summary

The Cerritos College Foundation (foundation) is a nonprofit organization that benefits the college by raising public awareness of the needs of the college, raising funds for facilities and programs, and providing short-term financial assistance and scholarships to students. We have concerns about the organization and operation of the foundation, particularly, the extent of the college president's authority over the foundation's operations, bylaw violations, and the failure of the foundation to reimburse the district for the direct costs it incurred in performing foundation business.

The foundation has adopted bylaws giving the college president much greater influence over its operations than presidents of other community colleges we surveyed. In addition, the foundation has not adhered to its own bylaws for electing new directors to the board. Rather than electing new directors by formal vote, the foundation uses an informal method of selection. Also, contrary to state regulations and its own bylaws, the foundation has not reimbursed the district for the payroll costs of district personnel that perform work for the foundation. This arrangement also fails to disclose the true cost of foundation activities and distorts the results of its operations. Furthermore, the foundation's board of directors did not approve the plan or budget for one of its events, and did not monitor expenses relating to the event. Finally, the district has not made the directors of its foundation aware of their conflict-of-interest responsibilities.

Foundation Bylaws Give the College President Greater Authority Than Other Community Colleges

The bylaws of the foundation give the college president the opportunity to exert greater influence over foundation operations than presidents of other community colleges we surveyed. According to its current bylaws, from 8 to 50 directors comprise the foundation's board of directors. Currently, there are 25 directors on the board. The college

president, who is also the district president, is a foundation director and has the authority to select four other directors, including three members of the district management staff and one member of the district faculty. The existing directors are supposed to elect the remaining members and select officers, standing committee chairpersons, and executive board members. The executive board has the authority to conduct the foundation's business and consists of 5 to 14 elected officers, the elected chairpersons of the standing committees, and the district president.

The college president has the authority to direct and control daily foundation business and make final decisions on its activities.

Under the current arrangement, the college president can exert considerable authority over foundation business. Since May 1997, the foundation's bylaws give the district president, subject to the control of the board of directors, the authority to direct and control the ongoing daily business of the foundation. In addition, he has the authority to select paid staff for the foundation and the authority to make the final decision in all foundation activities. Specifically, the foundation's bylaws allow the president the final decision in any disagreements with the foundation's executive board of directors on any action. Prior to the May revision, these disagreements were settled by a conference committee selected by the president and the foundation chairperson. This authority to have the final decision gives the president, should he choose, the ability to direct any action taken by the foundation.

According to the president, the foundation has been structured in this manner based on his understanding of Section 72672(b) of the California Education Code. This section gives the president the responsibility for determining that all foundation expenditures are in accordance with the policies of the district's governing board and that they are appropriate. Rather than interpreting this to mean the president should have ultimate authority in all foundation decisions, we believe this section of the code requires the president to monitor the foundation's expenditures for propriety and adherence to district policy. Moreover, other districts we surveyed have not established such a strong role for their respective presidents over foundation activities.

Cerritos College's Foundation Is Unlike Those of Other Community Colleges We Surveyed

We reviewed the bylaws and implementing regulations of five other community college foundations to determine what role the college president plays in the operations of their foundations. We noted that none of the five give the college

president the same authority as Cerritos College Foundation does. For instance, no other foundation gives the college president the authority to select directors without a vote of the board.

None of the five surveyed foundations give the college president the same level of authority over foundations to select board members and to make unilateral board decisions.

At San Diego Community College District, a multi-college district, there are 12 members on its auxiliary organization's board of directors. Seven of the directors, including the Chancellor of the district and three community college presidents, are selected based on their position with the district, just as the president is at Cerritos. Four other directors are faculty members elected by their respective faculty senates. The last member of the board is a student representative selected by the president of the district's board of trustees.

The Glendale Community College District's board has between 3 and 30 directors, with the president or designee serving as a director. All other directors are elected by the current board of directors.

In addition, none of the five auxiliary organization structures we reviewed give the authority to affect board decisions to one individual. In other words, there is no provision in any of the five foundations' bylaws allowing the president of the college or district to decide disagreements.

The Foundation Is Not Following Its Procedures for Electing Board Members

The foundation does not follow its approved procedures for electing new directors. Rather, the foundation uses an informal process to select new board members. This may give the appearance of undue influence in these selections because the entire board is not involved. Specifically, the bylaws stipulate that the membership committee submit the names of potential new directors to the board for a vote. After reviewing foundation board minutes for the past three years, we noted that only once did the board vote to admit a new director. In all other cases, individuals were simply introduced as new directors, without any indication of a vote. For example, the president either introduced an individual as a potential director at one board meeting and, at the next, introduced him or her as a new director, or the president simply introduced an individual as a new director without any prior notice. Over the past three years, 14 individuals became directors using this informal process. The absence of formal elections gives the appearance that the president could be significantly influencing the selection of the board members.

Over the past three years, one new director was voted on by the board while 14 individuals became directors using an informal process.

According to the dean of Institutional Advancement and Planning, who oversees the foundation's day-to-day operations, because the foundation was casually organized, it selected directors informally, without following its bylaws. Additionally, it was felt that the president was more familiar with the community business people so he was allowed to bring in new directors. Nevertheless, foundation members are aware that this informal method does not conform with written policies and, according to the dean of Institutional Advancement and Planning, they plan to begin following their policies immediately.

District Costs on Behalf of the Foundation Are Neither Reimbursed Nor Reflected in the Foundation's Financial Statements

During fiscal years 1994-95 and 1995-96, two district employees performed the foundation's day-to-day business functions. Also during this period, several other district employees worked on a project for the foundation designed to promote community awareness of the college. All of the employees who worked on foundation activities received their salaries and benefits from the district. However, the foundation did not reimburse the district. Additionally, the foundation does not reflect these costs in its financial statements, thus giving a distorted picture of its financial position for both fiscal years we reviewed.

Section 59257(j)(6) of the California Code of Regulations requires auxiliary organizations to reimburse the district for services district employees perform under the direction of the auxiliary organization. The foundation included this provision in its master agreement with the district and in its implementing regulations. However, during the two years we reviewed, the foundation has failed to reimburse the district for these significant payroll costs or to reflect such costs in its financial statements. We obtained estimates from district employees of the percentage of time they spent doing foundation work during the last two fiscal years. Using these estimates, we computed that the foundation should have reimbursed the district $65,153 in salaries and benefits for fiscal year 1994-95 and $105,839 for fiscal year 1995-96. By failing to reflect these costs, the foundation presented a distorted picture of its financial operations for the two years we reviewed. Moreover, during these two years, the foundation should have reimbursed the district approximately $171,000 but did not.

Contrary to state regulations, the foundation did not reimburse the district approximately $171,000 for the salaries and wages of district employees working on foundation activities during the last two fiscal years.

The foundation reported a net loss of $8,171 in its financial statements for fiscal year 1994-95. However, had it included the unreimbursed labor costs for that year, its true loss would have been $73,324. Likewise, had the foundation reflected the amount it owed the district for unreimbursed labor costs for fiscal year 1995-96, the foundation's financial statements that reported a profit of $27,787 would have shown a loss of $78,052. We believe that these are actual costs for operating the foundation and should be disclosed. Without such disclosure, the directors may not have been fully aware of the extent of the losses that the foundation incurred during fiscal years 1994-95 and 1995-96. The board of directors needs the foundation's full financial picture to make prudent decisions. Additionally, we believe that providing district personnel to the foundation without reimbursement is contrary to both the California Code of Regulations and the master agreement between the college and its foundation.

We discussed this matter with the college president, who believes that as long as the district personnel assigned to do foundation business are under his direction, reimbursement is not required. The president cites Title 5 of the California Code of Regulations, Section 59257, to lend support to his view that reimbursement is required only when the district employees perform work under the direction of the foundation. However, the president's interpretation of this section of the code presents difficulties because it does not address the reality that as the president of the college, he is also a key director of the foundation. Therefore, it is difficult to discern when a district employee is working under the direction of the president or the foundation. For this reason, we are not convinced by the president's argument that it is permissible for the foundation to benefit from the services of district personnel, but not reimburse the district for such services.

In May 1997, the board of directors approved a significant change to the foundation's implementing regulations and its master agreement with the district. This change stipulates the district will support up to the equivalent of one full-time, management-level employee and one full-time assistant for the foundation without any provision for reimbursement. Though approved by the foundation board and the district board of trustees, this action had not yet been approved by the Chancellor's Office. Section 72672(c) of the California Education Code requires that the district's implementing regulations be submitted for approval to the Chancellor's Office. In fact, we received a copy of a letter dated October 20, 1997 sent by the general counsel for the Chancellor's Office addressed to the president of Cerritos

College. In his letter, the general counsel informed the president that he had declined approval of the revised implementing regulations for the foundation. The general counsel based this decision on his conclusion that the district's practice of assigning its employees to perform work for the foundation without reimbursement is contrary to and inconsistent with state regulation.

According to the college president, the district believes that state regulations and the conventional practice of other community colleges support its use of district personnel for foundation business without reimbursing the district. Additionally, the president feels that the foundation has returned value to the district in excess of any costs incurred. Nonetheless, during the period we reviewed, the foundation's implementing regulations and master agreement required reimbursement to the district. Further, we believe the foundation's May 1997 revisions relieving it from reimbursing the district are contrary to state regulations.

Despite the college president's belief that state rules and conventional practice support the unreimbursed use of district personnel for foundation activities, it is our view that this practice violates state regulations.

When we contacted five other community college districts to determine whether it is customary practice for a district to supply its own employees to work for an auxiliary organization without reimbursement, two districts told us that some of its employees do work without reimbursement. Two other districts informed us that their foundations do reimburse them for all work district employees perform. The fifth district told us that its foundation is relatively new and has an agreement with the district that will allow some employees time to work for the foundation only during its first two years of operation. At the end of the two-year period, the foundation is required to reimburse the district.

Our survey, though limited, indicates that other districts allow their employees to work on foundation activities without receiving reimbursement. Nevertheless, it is our view that this practice violates state regulations.

The Foundation Did Not Adequately Monitor One of Its Projects

During the two fiscal years we reviewed, the foundation put on three major events. Two were the foundation's annual golf tournament, and one was an event to promote community awareness of the college. We reviewed the latter. Between February 1995 and April 1996, the foundation planned and put on a fair-like event to highlight the college's cultural diversity and to bring residents from various neighborhoods to the

college. Although the foundation board discussed the event and was periodically apprised of its status, it was not given the opportunity to approve either the plans or the budget for the event.

While the board did technically meet provisions of Section 72675 of the California Education Code requiring the board of an auxiliary organization to approve all expenditures and fund appropriations, it did so only retrospectively. Specifically, current practice dictates that at the end of each month, the board votes its approval of a treasurer's report containing the foundation's revenues and expenditures for the preceding month. However, without the opportunity to approve a specific budget for the event, the foundation board could not adequately monitor the reasonableness of the event's actual expenditures. Also, expenditures could have been made that did not conform with the foundation board's wishes. Although this particular project reported a profit of $7,066, this figure does not include the district labor costs of $62,065; the event actually lost $54,999. Had the board approved the plan and a budget for the event that included all the proposed costs, including district labor costs, and monitored these expenses, it may have scaled down the scope to limit the financial loss.

We recognize events promoting community awareness are a normal college foundation function but we believe careful event planning, monitoring, and spending are imperative to make the best use of foundation resources.

We recognize that events promoting community awareness are a normal function of college foundations and financial gain is not necessarily the only positive outcome. However, we believe careful event planning and monitoring, as well as prudent spending, is imperative to make the best use of foundation resources.

Board Members Are Not Informed of Conflict-of-Interest Rules

Foundation board members are unaware there are specific conflict-of-interest rules governing their actions. Sections 72677 through 72680 of the California Education Code establish the conflict-of-interest policies that govern board members of auxiliary organizations. Generally, these sections state that no member of the board of directors is allowed a financial interest in any contract or transaction the board enters into. If a director does have a financial interest, then that contract or transaction is void unless the interest is disclosed to the board and the board still approves the transaction without the vote of those directors with an interest. Additionally, if the transaction is found to be reasonable it still may be acceptable, even though a director with a financial interest voted on the matter.

However, the foundation has not implemented procedures to inform board members of these requirements. According to the dean of Institutional Advancement and Planning, the foundation officers were unaware of the conflict-of-interest requirements for board members. It is of primary importance that the members of the board be made aware that they must clearly disclose any interest they have in any pending piece of foundation business. If they are unfamiliar with these regulations, board members could unwittingly violate them.

We reviewed the only contract the foundation had awarded over the past three years to determine if any conflicts existed. The contract was competitively bid and the final selection of the winning bid was made by a committee based on specific criteria. Although the contract was appropriately bid and selected, there were two foundation directors on the committee. This could have posed a problem if either director had a financial interest in one of the competing bidders, but was unaware of the conflict-of-interest requirements. While we have no evidence to suggest a conflict existed, this situation illustrates the importance of directors needing to be aware they must disclose any interest they have in transactions of the foundation.

Conclusion

Foundation bylaws give the Cerritos College president the opportunity to exert greater influence over foundation operations than presidents of other community colleges we surveyed. The president has the authority to select a number of directors and to make the final decision in all foundation activities. We reviewed the bylaws of five other community college foundations and found that none of the five gave the president of the college or district such latitude. We also observed that the foundation does not follow its bylaws when electing new directors. We reviewed the foundation's board minutes for the past three years and found that only 1 of 15 new directors admitted to the board was voted in as required. The remaining 14 were simply introduced as new directors without any indication of a vote by the current directors.

Furthermore, even though the foundation's bylaws and the California Code of Regulations require the foundation to reimburse the district for work performed by district employees on foundation business, the foundation has failed to do so. During fiscal years 1994-95 and 1995-96, the foundation should have reimbursed the district approximately $171,000. In addition, the foundation failed to disclose these costs in its

financial statements, resulting in a distorted picture of the results of its operations. In fact, rather than a total net profit of $19,616 for fiscal years 1994-95 and 1995-96, as reported in the foundation's financial statements, the foundation actually sustained a total net loss of $151,376 for that time period.

Also, during the period between February 1995 and April 1996, the foundation sponsored a promotional event. The foundation's board of directors failed to approve the plan or budget for this project and did not monitor expenses relating to the event. Finally, foundation directors are unaware of conflict-of-interest regulations they must adhere to.

Recommendations

To more closely mirror other college auxiliary organizations and adhere to its own procedures and state regulations, the foundation should take the following steps:

- Revise the bylaws so that no one person, including the college president, has the authority to select directors without a vote or make the final decision over foundation activities.

- Follow its policies regarding admitting new directors to the board. As specified in the foundation bylaws, the membership committee should submit names of potential directors to the full board for a vote of approval.

- Repay the district for payroll costs incurred by the district during fiscal years 1994-95 and 1995-96 as a result of district personnel performing work for the foundation. In addition, the district should maintain accurate records of all work performed by district personnel on foundation business and seek periodic reimbursement from the foundation.

- Include district labor costs in its financial statements as they are actual foundation costs and are necessary to make appropriate decisions and reflect the true results of its operations.

To better control its activities and avoid potential conflicts of interest, the foundation should do the following:

- Have its board of directors prospectively approve and monitor all foundation events and projects, and periodically compare actual revenues and expenses to the approved budgets.

- Inform its board of directors of the conflict-of-interest requirements they are required to follow. At a minimum, a copy of the regulations should be distributed to all directors.

Chapter 3

Improved Disclosure by Key District Officials Is Needed

Chapter Summary

Better disclosure is needed from individuals holding those Cerritos Community College District (district) positions designated as required to file annual statements of economic interest. For example, the district's conflict-of-interest code requires certain district employees to file statements disclosing outside income and business interests, yet some employees may not be doing so. Without such information, potential conflicts of interest may go undetected.

Some Employees May Not Be Fully Disclosing Outside Income and Business Interests

Statements of economic interest are necessary to ensure disclosure of the business interests, assets, and income of public officials and employees that may be materially affected by their official actions.

We are concerned that some district employees required to make full disclosure of outside income or business positions may not have done so for calendar year 1996. Twenty-one employees were required to file statements of economic interest, including the district's board members, the college president, vice presidents, deans, directors, purchasing clerk, chief of campus police, student activities coordinator, and consultants when directed by the president. These filings ensure disclosure of the business interests, assets, and income of public officials and employees who may be materially affected by their official actions. In appropriate circumstances, these individuals are precluded from participating in college business in order to avoid conflicts of interest. All 21 of these individuals filed statements of economic interest; however, 16 checked a box indicating that they had no income or business positions to disclose.

Reportable outside income includes, among other items, any salary, wage, advance, dividend, interest, rent, proceeds from a sale, gift, forgiveness of a debt or loan, and any community property interest in a spouse's income; unless such income relates to salary or expense reimbursement from federal, state, or local government sources. Disclosure is mandatory for annual income above $250 and for gifts over $50.

We discussed this matter with the college president, who partially clarified this issue by pointing out that 9 of these 16 individuals were not legally required to report their outside income. It is possible that an individual might receive income that does not have to be reported, such as income from the district or another governmental entity. Regarding the reporting of a spouse's income, it is possible that either the individual did not have a spouse or had a spouse who did not receive any reportable income. However, for the remaining seven, the president was unable to explain whether these individuals had reportable outside income. Without such disclosures, potential conflicts could exist undetected. For this reason, we believe it would be prudent for the president to follow up on this matter by discussing specific requirements of the district's conflict-of-interest code with each of these individuals, to ensure that proper disclosure was made for their reportable outside income.

The president also provided us a letter dated July 7, 1997 from the code review coordinator of the Board of Supervisor's Office for the County of Los Angeles. This office reviews the district's conflict-of-interest code amendments. It was the opinion of the code review coordinator that five, and possibly all six, of the positions that the president had added as designated and the district board had approved as required to file disclosure statements for calendar year 1996 did not need to file. Further, it was the coordinator's opinion that the disclosure categories currently required for one of the designated district positions were too stringent and should be relaxed. According to the letter, it was the coordinator's position that, based on the Fair Political Practices Commission's (FPPC) regulations, only positions having purchasing, contracting, or leasing authority be designated as required to file annual statements of economic interest.

As a result of the code review coordinator's conclusion, the president now believes that only 15 individuals are required to file. However, we do not believe that the code review coordinator's position is accurate. We asked the code review coordinator what FPPC regulations she relied on to reach her conclusion. She referred us to two such regulations. The first regulation defines a designated employee required to file as any officer, employee, member, or consultant of an agency whose position is exempt from civil service status, unless the position is secretarial, clerical, or manual; is an elected office; or entails participating in decisions that may materially affect any financial interest. The second regulation refers to certain requirements that must be met before an amendment to an entity's conflict-of-interest code will be approved. Specifically, the regulation requires that the entity

disclose or prevent foreseeable potential conflicts of interest, provide each affected person with a clear statement of his or her duties under the code, and adequately differentiate between designated employees with different powers and responsibilities.

While both these regulations are instructive, neither seems to support the code review coordinator's conclusion that designated employees must have purchasing, contracting, or leasing authority before being required to file. In fact, enclosed in her letter to the president, the code review coordinator included guidelines state agencies use to determine filing status. These guidelines define a decision-maker as someone that has the authority to vote on a matter, appoint an individual, obligate or commit the entity to a course of action, or enter into any contractual agreement on behalf of the entity. The guidelines also define a decision-making participant as someone who negotiates with a government entity or private individual regarding a decision without significant substantive review; or someone who advises or makes recommendations to the decision-maker by conducting research or an investigation, preparing or presenting a report; or someone providing analysis or opinion requiring the employee to exercise judgment in an attempt to influence the decision.

We believe that these definitions provide a much broader scope concerning who should be designated as required to file. Presumably, the president and the district board considered these factors when designating and approving positions that require statements of disclosure.

Conclusion

Individuals holding district positions designated as required to file annual statements of economic interest may not have disclosed outside income and business interests in their annual disclosure statements. These statements require that the individual disclose, among other things, reportable outside income received and business positions held with entities other than the district. Of the 21 individuals who filed the statement, 16 checked a box indicating that they had no income or business positions to disclose. While the president provided information indicating that 9 of these 16 were not legally required to report their outside income, we still have concerns regarding the remaining 7. When disclosures are not made, potential conflicts could remain undetected.

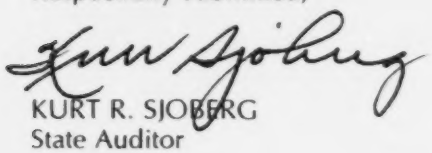
Recommendation

To guard against potential conflicts, the district should take the following step:

- Provide those individuals required to file annual statements of economic interest with adequate instructions on completing these statements.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in this report. The information in this report was shared with the district, and we considered its comments.

Respectfully submitted,



KURT R. SJOBERG
State Auditor

Date: October 27, 1997

Staff: Steven Hendrickson, Audit Principal
Doug Cordiner, CGFM
Ron Bawden, CPA
Michael Tilden, CPA
Dawn Tomita

Appendix

Additional Activities Audited

Part of our purpose in conducting this audit was to address concerns raised about the Cerritos Community College District's (district) handling of budgeting practices, shared governance, general state apportionment, and basic skills, matriculation, and Title III funding. We investigated the allegations but were unable to substantiate them. Below, we describe in detail our review of these areas and conclusions.

One concern was about an alleged lack of control over a line item in the fiscal year 1994-95 budget for the president's office. Reportedly, the president budgeted $1 million for use at his discretion. We reviewed the district's proposed budget for fiscal year 1994-95 to identify this line item. We found the amount in question was actually $675,000, and was included in a budget area designated for planning priorities. Furthermore, in the final budget for fiscal year 1994-95, it had been removed from the original budget area and used in other areas. For example, Instructional Services received $362,000 for computer labs, Student Services received $125,000, and Business Services $165,000 for hourly employees filling vacancies in those areas. Therefore, we concluded that the $675,000 line item was never included in the president's discretionary budget, and ultimately was transferred to areas with appropriate spending controls in place and used for appropriate purposes.

There was also a concern that the district failed to adhere to a policy of shared governance. Shared governance is a process of policy-making that allows all affected groups input prior to recommending a course of action to the Board of Trustees (board) for approval. To determine if the board was abiding by shared governance in its decision-making, we compared its regulations and policy guidelines to those formulated by the Chancellor's Office. Generally, the district followed the Chancellor's Office guidelines. For instance, the board created the Cerritos College Council (council) in December 1993. The council is comprised of members representing such constituent groups as administrators, faculty, staff, students, the foundation, and the community. The council holds regular meetings to reach a consensus on policy recommendations to the board.

Another concern was that the district inflated the number of full-time equivalent students (FTES) it reported to the Chancellor's Office to increase its share of general state apportionment and supplemental basic skills funds. The district receives supplemental basic skills funds for all remedial reading, writing, and mathematics courses that help students to meet the requisites for an associate degree.

To determine if the district accurately reported student attendance to claim these funds, we reviewed all the relevant laws and regulations as well as the attendance reporting procedures. In addition, we interviewed district staff to identify the procedures to report FTES. We also reviewed the work of the district's external auditors, which included testing the FTES reported in claiming apportionment funds; student residency classification; course repetition, probation, and dismissal procedures; and computation of contact hours of enrollment. Based on their work and our own review of that work, we concluded the district complied with the applicable laws and regulations.

In addition, there was an allegation that the district was using "semi-independent" courses inappropriately to increase the FTES reported to the Chancellor's Office to increase its general state apportionment funds. A semi-independent course is a regularly scheduled, nonlecture class held in the Math Learning Center. To determine if the district was properly reporting these FTES, we reviewed eight sections of semi-independent courses. Specifically, we reviewed the detailed attendance reports, permanent attendance rosters, permanent grade rosters, final grade rosters, and drop forms to determine that only those students meeting the reporting requirements for claiming FTES were included in the attendance reports submitted to the Chancellor's Office. Our review indicated that the district complied with the regulations.

Another concern was that the district was using its supplemental basic skills funding inappropriately. Specifically, the concern was that the money was used for the Ad Hoc Technology Taskforce (ATT) to upgrade technology on campus and that the reading department's request for equipment from ATT was denied. To determine the permissible uses of these funds, we obtained the Chancellor's Office criteria. Based on our own review and the information from the Chancellor's Office, we determined that funds for supplemental basic skills can be used at the discretion of the district's governing board for general instructional and operational purposes. Given this understanding and our review of how the district is spending these moneys, we concluded that the district had used these funds appropriately.

Still another concern centered on the district's use of matriculation funds. We reviewed those sections of the California Code of Regulations that outline the appropriate uses of this funding. In addition, we reviewed the district's matriculation plan approved by the Chancellor's Office to determine the intended use for these funds. To determine if the funds were spent appropriately, we chose a sample of 40 expenditures for testing: 22 from fiscal year 1995-96, and 18 from fiscal year 1996-97. For each expenditure, we reviewed the requisition request, purchase order, and invoice. In addition, we verified that these expenditures were for a component of the approved matriculation plan. We found that all the expenditures we tested were for permissible uses of matriculation funds.

Finally, there was a concern that Title III funds were being used for projects not included in the original grant proposal. One original project was for outreach efforts to the Hispanic community, largely through community organizations. However, the district instead used a portion of the money earmarked for that project to fund the President's Emphasis on Transfer (P.E.T.) project. P.E.T. focuses on improving the college's image among underrepresented student populations, helping students understand that earning a baccalaureate degree is a realistic goal, and getting students to focus on transferring to a four-year institution.

We interviewed district staff to gain an understanding of the P.E.T. project. In addition, we reviewed the grant proposal, performance reports, and award notifications for fiscal years 1995-96 and 1996-97. We found that the district reported in its initial performance report to the federal government that it would be changing certain aspects of the proposal. Specifically, the district reported its plan to include area high schools and clubs. Therefore, the federal government was informed of and approved this change prior to the district expending funds. In addition, based on the performance reports for the P.E.T. project submitted by the district, the federal government has since awarded the district Title III funding for a second and third year. Again, we found no support for the allegation.

CERRITOS COMMUNITY COLLEGE DISTRICT
11110 ALONDRA BOULEVARD • NORWALK, CALIFORNIA 90650-6298 • (562) 860-2451 • FAX (562) 860-1104

Office of the President • Dr. Fred Gaskin

MEMO TO: Cerritos Community College District Residents
Cerritos Community College Employees
Members of the California Legislature
Kurt Sjoberg, State Auditor
Interested Readers

FROM: Bob Verderber, President
Board of Trustees
Cerritos Community College

Bob Verderber

DATE: October 21, 1997

SUBJECT: Audit Response

I am pleased that the state auditors confirmed what I knew: **the allegations of the "Concerned Citizens" could not be substantiated.** (1)* The issues raised included the handling of budgeting practices, shared governance, general state apportionment, basic skills, matriculation, and Title III. Regarding these issues, the audit report states: **"We investigated the allegations but were unable to substantiate them."** I commend the staff of the District for their integrity, honesty, and attention to detail.

CONFIRMATIONS

The audit confirmed:

1) **The district correctly reported FTES for its general state apportionment, amounting to a combined total of $85,339,984 for 1995-96 and 1996-97, and supplemental basic skills funds for a total of $1,467,762 for this same period.** (2)

2) **The district properly spent matriculation funds (in each of 40 sample cases audited). Hence, the $1,500,779 in matriculation funds received in 1995-96 and 1996-97 were appropriately allocated and managed.** (3)

*The California State Auditor's comments on this response begin on page 67.

BOARD OF TRUSTEES:
BOB VERDERBER, PRESIDENT • JOHN MOORE, VICE PRESIDENT
BOB ARTHUR, SECRETARY • DOROTHY CARFRAE • TED EDMISTON
CHERYL A. EPPLE • MARY LOYA • KELLY STORTZ, STUDENT MEMBER

3) **The district's use of supplemental basic skills funds in the amount of $1,467,762 could indeed be used at the discretion of the board of trustees for general instructional and operational purposes.**

4) **The college president did not have a $1 million discretionary budget. Rather, the district Planning and Budgeting Committee had set aside $675,000, through its shared governance process, for funding planning priorities. These funds were never in the president's budget to begin with. The audit states, "Therefore, we concluded that the $675,000 line item was transferred to other areas with appropriate spending controls in place and was used for appropriate purposes."**

5) **The district fully and correctly complied with the Chancellor's Office regulations regarding attendance reporting in "semi-independent" courses.**

6) **The district followed the Chancellor's Office guidelines regarding the required practice of shared governance in policy-making.**

7) **The district appropriately spent funds and reported necessary changes in its Title III project to federal authorities. Funds included in this review amounted to $635,123.** (4)

After the audit's comprehensive review of the numerous allegations of wrongdoing made by the "Concerned Citizens," we indeed were found to be aboveboard in our conduct and practices. The audit found that in most instances there was no evidence of problems. The Bureau of State Audits could not substantiate the majority of criticisms lodged at the district. We appreciate the work conducted to confirm the facts: there was little basis for the concerns brought forward to the Joint Legislative Audit Committee.

We found it demoralizing, though, that the audit report hid the bulk (5) of these confirmations in the report's appendix. The findings of the State Audit Report are important. I have steadfastly maintained that the college was operationally and fiscally sound. These findings (6)

support my contention and will instill confidence in District governance. The campus and community will welcome this information. The State Audit Team has explained that protocol requires these findings be placed in an appendix -- a protocol which seems less than sound to me. But the information in the appendix is the heart of the report for this community.

The State Audit did identify a few shortcomings, however. Some of what was found we already knew and either had resolved or were in the process of resolving. The sole remaining issue concerned the college Foundation. We have operated in good faith and will maintain our position of propriety in this regard.

ACKNOWLEDGMENTS

We acknowledge the need for improvement in the operation and management of the bookstore. In fact, the district had issued two contracts (for a total of $25,392) and completed special audits of this activity prior to the State Audit and is well on its way to resolving problems.

The State Audit did make a few additional recommendations, which have been implemented. The former method of reporting debit and credit memos, which resulted in reporting an excessive combined average ($618,000) higher than that found at comparison colleges, was changed at the recommendation of the state auditing team. **This new method of netting debit and credit memos against invoices resulted in a dramatic reduction of the combined average to $80,000 and clarified our status as being well within the parameters of other colleges** (Attachment 1). (7) (8)

Also as mentioned in the audit, the textbook buy back process would be improved by securing timely information from faculty about textbooks needed for the subsequent semester. The vice president of academic affairs will work closely with the division deans to secure book requisitions from faculty earlier during the semester for the upcoming term.

Furthermore, the previous method of valuing the bookstore inventory was determined to be not in accordance with generally

accepted accounting principles. From previous audits the valuation issue was not seen as a material finding. This practice will be changed and each book title will be evaluated on a case by case basis to determine the most equitable valuation method

The past practice of counting and reconciling cash drawers in the bookstore was cited as inadequate. **While no real incidence of a problem with overages or shortages was found, the audit did uncover a potential accountability problem with the process used.** A new step will be added to the process which will require each cashier to count and log cash amounts at the end of the shift.

We acknowledge there may have been some misunderstanding on the part of a few individuals in filing their conflict of interest statements and that the Foundation Board of Directors should be given explicit information about conflict of interest matters. To this end, the District will develop a clearer set of instructions for completing the statements and amend the Foundations Directors' Orientation Manual to include a section on conflict of interest. **The audit's findings, however, refer to the possibility of violations of conflict of interest. The real and more important finding was that the auditing team found not one incidence of conflict of interest.** (9)

We acknowledge that the Foundation's past practice of bringing on new board members was less than formal (not through an election, but more by way of consensus). The master agreement and bylaws for operating the Foundation, however, had been redrafted, approved and enforced prior to the conclusion of the State Audit by the District Trustees and Foundation Directors to require a formal process of nominating and electing directors by a majority vote.

OBJECTIONS

We disagree with the audit's position that the use of district staff on Foundation activities is improper or that the presidential authority exercised with the Foundation is inappropriate. The Foundation's master agreement with the district trustees, amended and approved on May 28, 1997, clearly allows the actions we have taken. **The district and Foundation have operated openly and in good faith** (Attachment 2). **The use of District staff to support the Foundation is** (10) (11) (12)

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a common practice throughout California Community Colleges. The intrinsic "goodwill" value of the Foundation to the District greatly exceeds the cost factor.

According to the Chancellor's Office correspondence dated October 20, 1997 (Attachment 3), our interpretation of the Education Code was plausible and our practice of using district staff on Foundation work was "based on good faith." The college's revised master agreement and implementing regulations were, however, ultimately not approved by the Chancellor's Office because of the legal requirement placed on the foundation to reimburse the district for costs of service provided by district employees. **Because we were operating in good faith, however, the Chancellor's Office made clear its position "...that we are not suggesting that the Cerritos College Foundation must retroactively reimburse the District for the work that these employees have done in the past."** (13)

The master agreement between the district and the foundation will be revised to include the provision of a more detailed listing of the benefits received by the district that equal or exceed the cost of the services rendered by the district employees in any given year. Submission of this modification to the Chancellor's Office for review and approval was offered by the Chancellor's Office General Counsel as a constructive solution to the current situation. (13)

Furthermore, we disagree with the finding that the Foundation did not adequately monitor one of its projects. **The community awareness project to which the audit refers, "Windows to the World," was in reality a college event held as part of the year-long 40th anniversary celebration of Cerritos College.** The Foundation served as a sponsor, as did many other agencies, but was not responsible for organizing or managing the event. The Foundation did provide the means for holding and spending sponsorship funds for the project and these activities were reported to the board of directors on a monthly basis on financial reports. District staff worked on the event during their regular work schedules at district expense because the 40th Anniversary Celebration was indeed a district-support activity. Regular updates were provided at the Board of Trustees meetings and trustees actively promoted the event in the community. Over (14)

100 staff volunteered their time during the days of the event to contribute to the anniversary celebration.

RESPONSE TO RECOMMENDATIONS:

1. Offset its accounts receivable balances from book publishers against any outstanding amounts that are owed to the publishers by the district.

This recommendation has been implemented. (7)

2. Obtain book requisitions from instructors during the prior semester for the upcoming term, so that the bookstore can better forecast its needs for new books and better manage its used book buybacks.

The Vice President for Academic Affairs will work closely with the Division deans to secure book requisitions as recommended.

3. Revise the bylaws so that no single person, including the college president, has the authority to select directors without a vote or make the final decision over the functions and activities of the Foundation.

The current practice has been reviewed and is supported by the Chancellor's Office. (11)

4. Follow its written policies and bylaws regarding admitting new directors to the board. As specified in the Foundation bylaws, the membership committee should submit names of potential directors to the full board for a vote of approval.

This recommendation has been implemented.

5. Repay the district for payroll costs incurred by the district during fiscal years 1994-95 and 1995-96 as a result of district personnel performing work for the Foundation. In addition, the district should maintain accurate records of all current and future work performed by district personnel on Foundation business until it

receives a ruling from the Chancellor's Office regarding this practice.

The Chancellor's Office has determined that no repayment is required because the college operated in good faith. Because we were operating in good faith, however, the Chancellor's Office made clear its position "...that we are not suggesting that the Cerritos College Foundation must retroactively reimburse the District for the work that these employees have done in the past." (13)
We will amend the Master agreement to detail the benefits accrued to the district that equal or exceed the costs of services provided by the district.

6. *Provide those individuals holding district positions designated as required to file annual statements of economic interest with adequate written or oral instructions on how to complete these statements.*

A clearer set of written instructions will be developed and distributed. Oral instructions will also be provided.

In summary, for the past six months the state auditor has investigated the Cerritos Community College District. No illegal or improper activities were found. Certain so called "weaknesses" in our bookstore operation were identified. We pointed out these weaknesses before the audit began and took steps to correct them. (15)
The audit took exception to our use of District staff to support the Foundation. We respectfully disagree and rely on the fact that this activity is a general practice of the majority of California Community Colleges and within the scope of the California Education Code. (12) (16)

Attachments

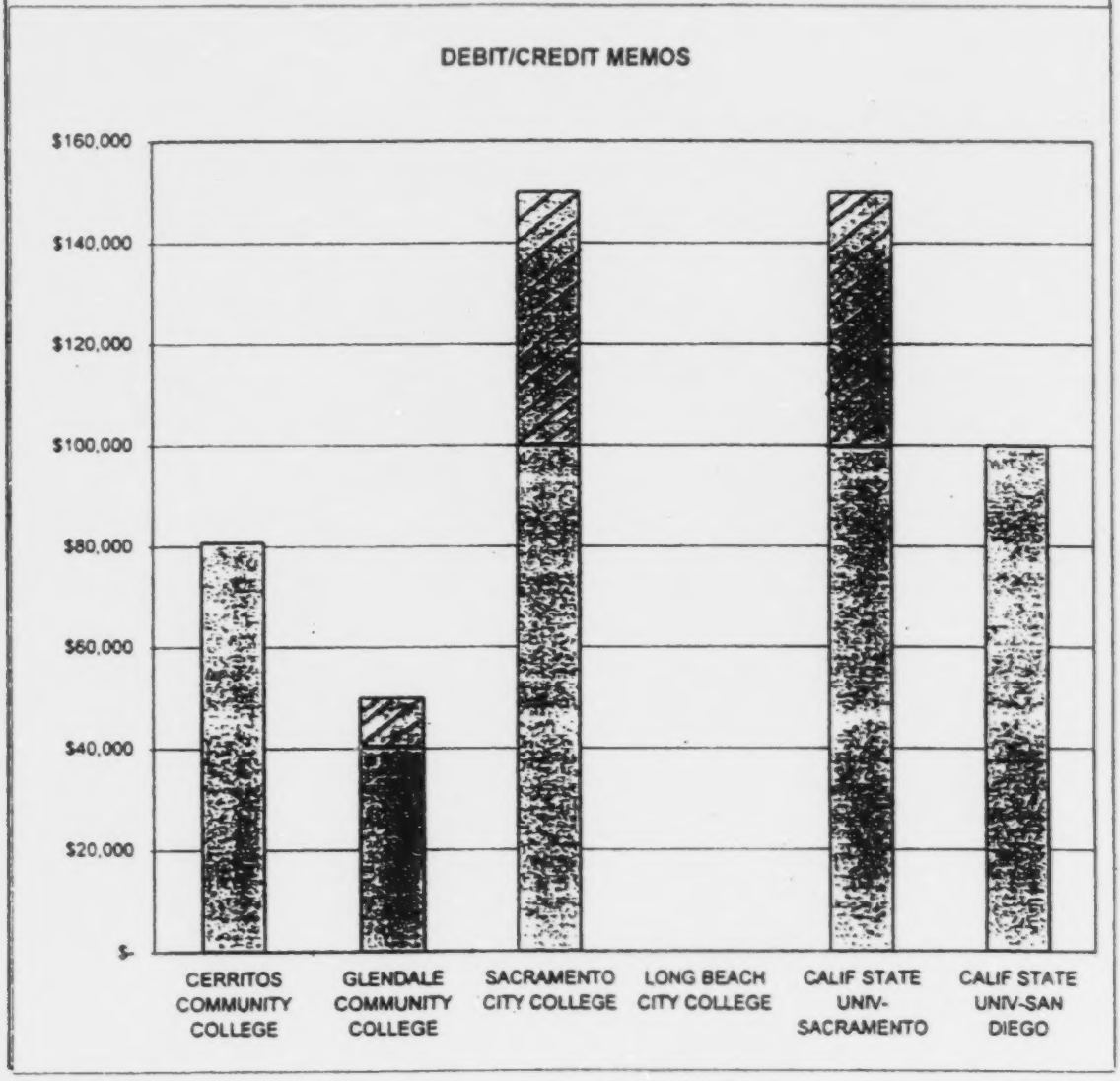
CERRITOS COLLEGE

AUDIT RESPONSE

ATTACHMENT 1

AVERAGE COMBINED BALANCE OF DEBIT AND CREDIT MEMOS

CERRITOS COMMUNITY COLLEGE	$	80,800
GLENDALE COMMUNITY COLLEGE	$	50,000
SACRAMENTO CITY COLLEGE	$	150,000
LONG BEACH CITY COLLEGE	$	-
CALIF STATE UNIV-SACRAMENTO	$	150,000
CALIF STATE UNIV-SAN DIEGO	$	100,000



ANALYSIS OF NETTING DR/CR MEMOS & INVOICES

VENDOR NAME		DR/CR		INVOICES
ADDISON-WESLEY	$	89,178.70	$	91,001.26
NET AMOUNT	$	-	$	1,822.56
AMERICAN TECHNICAL	$	175.26	$	778.80
NET AMOUNT	$	-	$	603.54
ASPEN PUBLISHERS	$	54.40	$	6,546.96
NET AMOUNT	$	-	$	6,492.56
BANTAM DOUBLEDAY	$	256.39	$	432.00
NET AMOUNT	$	-	$	175.61
COLLEGE PUBLISHERS	$	3,895.33	$	46,495.30
NET AMOUNT	$	-	$	42,599.97
COPPERHOUSE PUBLISHING	$	1,318.00	$	4,894.62
NET AMOUNT	$	-	$	3,576.62
COURSE TECHNOLOGY	$	10,770.21	$	24,974.44
NET AMOUNT	$	-	$	14,204.23
DACAPO PRESS	$	13.56	$	196.00
NET AMOUNT	$	-	$	182.44
DAME PUBLICATIONS	$	883.32	$	1,905.45
NET AMOUNT	$	-	$	1,022.13
EMC PUBLISHING	$	287.60	$	11,515.20
NET AMOUNT	$	-	$	11,227.60
FOLLETT CAMPUS RESOURCE	$	36,076.97	$	18,853.78
NET AMOUNT	$	17,223.19	$	-
HACKETT PUBLISHING	$	47.76	$	542.40
NET AMOUNT	$	-	$	494.64
HARCOURT BRACE	$	37,290.13	$	140,347.56
NET AMOUNT	$	-	$	103,057.43
HARPER COLLINS PUBLISHERS	$	7,382.51	$	11,778.71
NET AMOUNT	$	-	$	4,396.20
HOUGHTON MIFFLIN CO.	$	45,733.62	$	106,958.58
NET AMOUNT	$	-	$	61,224.96
TOTALS ON DR/CR & INVOICES	**$**	**233,363.76**	**$**	**467,221.06**
NEW AMOUNTS ON DR/CR & INV	**$**	**17,223.19**	**$**	**251,080.49**
AMNT TO BE DEDUCTED FROM LIST	**$**	**216,140.57**	**$**	**216,140.57**

ANALYSIS OF NETTING DR/CR MEMOS & INVOICES

VENDOR NAME		DR/CR		INVOICES
I.T.P.	$	93,956.67	$	132,385.01
NET AMOUNT	$	-	$	38,428.34
INGRAM BOOK	$	492.77	$	1,290.18
NET AMOUNT	$	-	$	797.41
IRWIN,RICHARD D.	$	436.00	$	2,865.57
NET AMOUNT	$	-	$	2,429.57
KEY CURRICULUM	$	478.30	$	4,179.27
NET AMOUNT	$	-	$	3,700.97
MAJORS	$	15,756.52	$	14,407.65
NET AMOUNT	$	1,348.87	$	-
MACMILLAN PUBLISHING	$	1,675.31	$	2,975.37
NET AMOUNT	$	-	$	1,300.06
MAYFIELD	$	7,042.93	$	21,691.74
NET AMOUNT	$	-	$	14,648.81
MCGRAW HILL	$	37,919.45	$	78,662.12
NET AMOUNT	$	-	$	40,742.67
MICROSOFT PRESS	$	503.20	$	156.41
NET AMOUNT	$	346.79	$	-
MOSBY	$	17,735.69	$	3,039.54
NET AMOUNT	$	14,696.15	$	-
MOUNT ST MARY'S	$	238.00	$	432.00
NET AMOUNT	$	-	$	194.00
NACSCORP	$	684.81	$	7,817.23
NET AMOUNT			$	7,132.42
NEBRASKA BOOK CO	$	12,611.42	$	20,484.11
NET AMOUNT			$	7,872.69
NTC PUBLISHING	$	1,123.72	$	661.09
NET AMOUNT	$	462.63	$	-
OXFORD UNIVERSITY PRESS	$	38.88	$	2,170.20
NET AMOUNT	$	-	$	2,131.32
TOTALS ON DR/CR & INVOICES	**$**	**190,693.67**	**$**	**293,217.49**
NEW AMOUNTS ON DR/CR & INV	**$**	**16,854.44**	**$**	**119,378.26**
AMNT TO BE DEDUCTED FROM LIST	**$**	**173,839.23**	**$**	**173,839.23**

ANALYSIS OF NETTING DR/CR MEMOS & INVOICES

VENDOR NAME		DR/CR		INVOICES
PRENTICE HALL, INC	$	108,477.05	$	294,273.77
NET AMOUNT	$	-	$	185,796.72
PUBLISHERS GROUP WEST	$	251.64	$	634.98
NET AMOUNT	$	-	$	383.34
SIMON & SCHUSTER	$	2,058.20	$	4,747.07
NET AMOUNT	$	-	$	2,688.87
SPRINGHOUSE PUB	$	352.17	$	451.85
NET AMOUNT	$	-	$	99.68
STERLING EDUCATION MEDIA	$	2,367.51	$	987.19
NET AMOUNT	$	1,380.32	$	-
TOWNSEND PRESS	$	1,469.80	$	19,992.10
NET AMOUNT	$	-	$	18,522.30
UNIVERSITY OF CHICAGO	$	1,319.32	$	296.81
NET AMOUNT	$	1,022.51		
VHPS	$	4,886.06	$	31,142.11
NET AMOUNT	$	-	$	26,256.05
W.W. NORTON & COMPANY	$	28,258.23	$	45,425.34
NET AMOUNT	$	-	$	17,167.11
WEST PUBLISHING GROUP	$	543.32	$	2,531.88
NET AMOUNT	$	-	$	1,988.56
TOTALS ON DR/CR & INVOICES	**$**	**149,983.30**	**$**	**400,483.10**
NEW AMOUNTS ON DR/CR & INV	**$**	**2,402.83**	**$**	**252,902.63**
AMNT TO BE DEDUCTED FROM LIST	**$**	**147,580.47**	**$**	**147,580.47**

CERRITOS COLLEGE

AUDIT RESPONSE

ATTACHMENT 2

CERRITOS COMMUNITY COLLEGE DISTRICT
11110 ALONDRA BOULEVARD • NORWALK, CALIFORNIA 90650-6298 • (562) 860-2451 • FAX (562) 860-1104

Office of the President • Dr. Fred Gaskin

October 7, 1997

VIA FAX AND US MAIL

ATTACHMENT 2

Mr. Ralph Black, General Counsel
and Vice Chancellor
California Community Colleges
1107 Ninth Street
Sacramento, CA 95814-3607

Dear Ralph:

Thank you for taking time to talk with me yesterday regarding the Cerritos College Foundation. As promised, the following information is submitted to support our position and provide additional background information for you.

According to Dr. Jan Dennis-Rounds, our college dean with responsibility for institutional advancement and planning, Network of Community College Foundations (NCCCF) has shared information with its membership that endorses the use of District resources (including staff) on behalf of the college foundations. In fact, she has told me "Title V was changed by the state legislature in 1990 to allow college foundations to become auxiliary organizations to the community colleges whereby District support and oversight could be provided."

Furthermore, she has indicated to me NCCCF has sponsored speakers to clarify the practice of District support of community college foundations. In a presentation at the 10th annual NCCCF Symposium, Michael D. Schley, Attorney at Law, explained that the purpose of the Master Agreement (required by Title V) between the District Board of Trustees and the Foundation Board of Directors is to delineate the terms of the Foundation's use of District resources in return for the support provided by the Foundation (see attached outline).

Dr. Dennis-Rounds has also reported conversations she has had with Mr. John W. Francis, Attorney at Law, about his early involvement with the California Community College Chancellor's Office which resulted in the 1990 Title V changes. According to her, "Mr. Francis worked closely with Tom Nussbaum to put forth language which would allow Districts the flexibility to provide support as they deemed necessary. They had an understanding that the Chancellor's Office would authorize Districts to establish these conditions with their auxiliary Foundations if they had been so determined in the master agreements." Mr. Francis has worked with many California community colleges in drafting master agreements with this understanding.

Please feel free to discuss this matter further with Dr. Dennis-Rounds. She can be reached at (562) 860-2451, ext 2536.

Sincerely,

Fred Gaskin

Attachment

cc: Mr. Steve Hendrickson (w/attachment)

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The College/Foundation Master Agreement: Pros, Cons and Options

Michael D. Schley
October 17, 1996

Presentation Outline
in connection with the panel

The College/Foundation Relationship: Tricky Ground?

Network of California Community College Foundations
10th Annual Symposium
Santa Barbara, California

The College/Foundation Master Agreement: Pros, Cons and Options

Michael D. Schley
October 17, 1996*

Introduction: This presentation is about the "master agreements" between community college districts and their foundations. It discusses why they are necessary or desirable, and what they should address.

1. **First, a bit of background:**

   a. **"Foundation"** denotes a separate corporate entity. At some colleges, all development is done by college staff, through an in-house development office. This is not a "foundation."

   b. An **"independent foundation"** is a nonprofit corporation established under corporations laws. Like any charity, it:

      i. has articles of incorporation and bylaws

      ii. is incorporated by filing its articles with the California Secretary of State

      iii. has an independent board of directors

      iv. obtains its tax-exempt status from:

         (1) the California Franchise Tax Board
         (2) the Internal Revenue Service (under Internal Revenue Code §501(c)(3))

   c. An **"auxiliary foundation"** is also a nonprofit corporation, but it is different from most charities because it must comply with specific rules under the Education Code (§§72670-72682) and implementing regulations.

      i. Like an independent foundation, an auxiliary:

         (1) has articles of incorporation and bylaws

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* Presented as part of a panel discussion, "The College/Foundation Relationship: Tricky Ground?" at the 10th Annual Network of California Community College Foundations Symposium on October 17, 1996. The author wishes to thank his co-panelists, Howland Swift and Marti Kessler, and approximately two dozen community college presidents and foundation directors who responded to the author's survey on master agreements.

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(2) is incorporated by filing its articles with the California Secretary of State

(3) has a board of directors (but see below regarding limits on their independence)

(4) obtains its tax-exempt status from:

(a) the California Franchise Tax Board
(b) the Internal Revenue Service (under Internal Revenue Code §501(c)(3).

ii. In contrast to an independent foundation, an auxiliary:

(1) is, in effect, an agency of the college

(2) is established under, and must abide by, regulations issued by the college

(3) must pay wages, salaries and benefits to its employees that are comparable to those provided to college employees

(4) may have its employees participate in CalPERS

(5) must have a master agreement with the college covering the following issues, if they are not already addressed in the district's regulations:

(a) the function of the auxiliary
(b) a statement of rationale and purpose of the auxiliary
(c) the auxiliary's areas of authority and responsibility
(d) the district facilities to be made available to the auxiliary
(e) the charge or rent to be paid by the auxiliary
(f) full reimbursements by the auxiliary
(g) the liability of the auxiliary for indirect costs
(h) the responsibility for operating expenses
(i) policies regarding public relations expenditures
(j) the disposition of the auxiliary's earnings
(k) the disposition of net assets on dissolution

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(l) maintenance of corporate existence during the period of the master agreement.

5 C.C.R. §59257

The net effect of these rules is to put an auxiliary squarely under the control of the district. Though an auxiliary has its own board of directors, the effect of the governing regulations and the master agreement is usually to give the district the final say on any matters affecting the auxiliary.

2. **Why have a Master Agreement?**

a. **Auxiliaries might not have a choice.** A master agreement is not, literally, required by law for every auxiliary; it is optional. However, it is usually required, as a practical matter, because the district's regulations for auxiliaries generally will not be specific enough to cover all of the requirements of 5 C.C.R. §59257 (above).

b. **The "gift" question.**

i. The Education Code specifically prohibits a "gift" of facilities to outside entities:

§81440. Notwithstanding any other law, no governing board of a community college district shall do either of the following:

(a) Make a gift of district real property to any entity that is not established by the district pursuant to Article 6 (commencing with Section 72670) of Chapter 6 of Part 45.

(b) Lease real property for less than fair rental value, as defined in paragraph (2) of subdivision (c) of Section 82542, to any entity unless the entity meets one of the following conditions:

(1) It is established by the district pursuant to Article 6 (commencing with Section 72670) of Chapter 6 of Part 45.

(2) It is described in Section 82537.

(3) It is described in Section 72682.

(4) It was in existence on August 31, 1980, and has been or is subsequently recognized by the governing board of a community college district as having a formal relationship with, and working on behalf of, the district or a constituent college thereof.

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ii. Auxiliary foundations are among the exceptions listed above, but independent foundations are not. Furthermore, administrative regulations suggest it may be illegal to provide free space and services even to an auxiliary foundation.

iii. A college typically wants to provide free space, and perhaps support services, to its foundation, to support its development activities for the benefit of the college.

iv. The master agreement can establish that the provision of space and services is on an arm's length basis, not a prohibited gift. The agreement should recite all of the benefits provided by the foundation to the college (including cash gifts far in excess of the value of the space and services), as evidence that the space is neither a gift nor a lease for less than fair market value. To this author's knowledge, the issue has never been taken up by a court, but the consideration set forth in a master agreement should help overcome any question of violation of Education Code §81440.

c. **Setting the parameters of the college/foundation relationship.**

A good master agreement will give comfort to the college administration regarding its relationship with the foundation. Among other things, it should address:

i. Whether the college will have *ex officio* representation on the board, or in the management, of the foundation

ii. Whether the college will have other means of controlling the foundation, such as:

(1) the power to "pull the plug" on the foundation -- *i.e.*, to terminate its corporate existence and force its liquidation

(2) veto power over certain decisions or policies

(3) the right to approve (or disapprove) activities by the foundation other than pure fundraising -- *e.g.*, contract education programs that might conflict with those of the college.

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Note: For an *independent* foundation, provisions of this type would appear to be inconsistent with the independence that must be exercised by a corporation's board of directors.

iii. Whether the college has a residual interest in the assets of the foundation upon its liquidation – *i.e.*, a provision in the articles that may not be changed without the college's consent

iv. Whether the foundation must report regularly to the college, whether it must be audited, and whether it may be subject to audit or inspection by the college.

3. **Sample Provisions.** The following may provide good samples of terms that should be included in a master agreement:

a. Auxiliaries:

i. In response to an informal survey by the author, most auxiliary foundations sent copies of agreements that are verbatim copies of the Coastline Community College (found at page 72 of the Network's *Foundation Manual and Guide*).

ii. Attached as Appendix A to this outline is a more detailed and original agreement between another college and its auxiliary foundation. Both this model and the Coastline Community College model have been approved by the Chancellor's Office.

b. Independents: The model attached as Appendix B is an agreement between another college and its independent foundation. Note that, appropriately, the agreement does not give the college the power to control the foundation.

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CERRITOS COLLEGE

AUDIT RESPONSE

ATTACHMENT 3

CHANCELLOR'S OFFICE

CALIFORNIA COMMUNITY COLLEGES
1107 NINTH STREET
SACRAMENTO, CA 95814-3607
http://www.cccco.edu
(916) 445-8752

October 20, 1997

Fred Gaskin, Superintendent/President
Cerritos Community College District
11110 Alondra Blvd.
Norwalk, CA 90650-6298

Dear President Gaskin:

On July 14, 1997, you submitted for our approval revised district implementing regulations for the recognition of auxiliary organizations in the Cerritos Community College District. We have reviewed the revised regulations and, with one exception, we find that they are consistent with applicable legal requirements. The exception is Section 1.7a of your revised regulations which states, "The District will provide, at District expense, personnel support up to the equivalent of one full-time 12 month, professional management level position, and up to the equivalent of one full-time, 12 month, Foundation assistant position." This is not consistent with Title 5, Section 59257(j)(6) which requires that district implementing regulations contain, among other things, "provisions which shall specify ... full reimbursement to the district for services performed by district employees under the direction of the auxiliary organization."

Before reaching this conclusion we carefully considered the arguments and evidence you supplied in your letters to me dated October 3, 1997, and October 7, 1997, and your letter of September 12, 1997, to Doug Cordiner of the Bureau of State Audits. As we understand it, you have made basically two arguments: (1) that district employees commonly do work for auxiliary organizations without reimbursement in many districts and that such practices have been previously approved by the Chancellor's Office, and (2) that the Cerritos CCD employees in question are working under your supervision and not "under the direction" of the Cerritos College Foundation. We address each of these arguments below.

We cannot directly confirm or refute your contention that many community college districts do not require auxiliary organizations to provide full reimbursement for work performed by district employees. However, we have reviewed all 22 sets of district implementing regulations which have been approved by the Chancellor's Office and none contains a provision similar to the one you proposed. We have approved several sets of district implementing regulations which provide that auxiliary organizations which are established as student organizations pursuant to Education Code Section 76060 et seq. may be exempt from the reimbursement requirement, but this is permissible because there is language in Education Code Section 76065 indicating that the costs of staff who oversee student organizations may be charged to district funds.

Aside from this exemption for student organizations, we can find no record of any instance in which the Chancellor's Office has ever approved a set of district implementing regulations which provided that district employees could perform work for an auxiliary organization without reimbursement. In particular, we looked carefully at the records we have with respect to the Coast Community College District which was specifically referenced in your letters. The implementing regulations approved for the Coast CCD provide for full reimbursement by auxiliary organizations of work performed by district employees, and the master agreement which we have on file for that district contains similar provisions.

Master agreements are supposed to be filed with the Chancellor's Office, but this does not always happen because we are not required to approve master agreements so long as all necessary provisions are all set forth in the district implementing regulations. Thus, it is possible that some districts may have entered into master agreements that have not been filed with our office. It is also possible that some districts do not always receive full reimbursement for work performed by district employees, even though the district implementing regulations require such reimbursement. However, this does not prove that the Chancellor's Office has approved such practices or that they comply with the requirements of law.

Your second argument raises a more difficult question regarding the interpretation of Section 59257(j)(6). It is certainly true, as you point out, that community college districts have general authority under Education Code Section 70902(b)(4) to employ and assign all district employees in a manner not inconsistent with state law. We must also acknowledge that the language of Section 59257(j)(6) is not entirely clear. Nevertheless, for the reasons discussed below, we conclude that

assigning district employees to perform work for an auxiliary organization without reimbursement is contrary to and inconsistent with Section 59257(j)(6).

First, we believe your interpretation of Section 59257(j)(6) would render that provision virtually meaningless. As we understand it, your view is that district employees are acting under your direction, not the direction of the auxiliary organization, so long as they report to or are accountable to you. Of course, all district employees are ultimately accountable to the superintendent/president, so the logical extension of your argument is that district employees never work "under the direction of the auxiliary organization." Were this the case, there would have been no reason for the Board of Governors to have adopted Section 59257(j)(6).

Second, we believe that your interpretation of Section 59527(j)(6) is contradicted by the second sentence of that provision, which states: "Methods of proration where services are performed by district employees for the auxiliary organization shall be simple and equitable." Even if the first sentence of Section 59257(j)(6) is read narrowly to apply only when work is performed "under the direction of the auxiliary organization," the second sentence clearly contains no such limitation. It would appear to require prorated reimbursement in any case where district employees perform some work for the district and some work for the auxiliary organization, whether or not that work is "under the direction" of the auxiliary organization. If, as you suggest, the first sentence establishes a different rule, then it could apply only to situations where the district employee worked exclusively on auxiliary organization business. However, if an auxiliary organization is required to reimburse the district for all work performed for the auxiliary organization when the employee also works on district business, then it would make little sense to say that this isn't necessary if the person works exclusively on auxiliary organization business so long as he or she isn't "under the direction of the auxiliary organization."

Moreover, we understand that the actual situation at Cerritos CCD is that the two employees in question only spend part of their time doing work for the Foundation. Thus, even if we did accept your interpretation, those employees would be governed by the second sentence of Subsection (j)(6) and reimbursement would still be required.

Finally, there are significant practical problems with the interpretation you suggest. If we do draw a distinction between work performed for an auxiliary organization and work performed under its direction, then we are compelled to get into complex questions of exactly how work is performed, who gives the orders, etc. For example, your theory might

suggest that reimbursement would be required if a district employee undertakes to perform a service when he or she receives a direct order from an official of the auxiliary organization, but we presume that you would take the position that the auxiliary organization need not provide reimbursement if the auxiliary organization submits a written request and you initial the request indicating your approval for the work to be done. This distinction is even harder to draw in the case of Cerritos CCD where, as we understand it, you serve both as Superintendent/President of the District and President of the Board of Directors of the Cerritos College Foundation. We would not reject your interpretation on this ground alone, but we do believe it would lead to significant problems with respect to auditing and enforcement and this serves to reinforce the purely legal arguments presented above.

For the forgoing reasons, we cannot approve the revised implementing regulations you submitted. However, I want to make clear that we are not suggesting that the Cerritos College Foundation must retroactively reimburse the District for the work that these employees have done in the past. This is a case of first impression on a point of law which is not entirely clear cut. We have ultimately rejected your interpretation of the law, but this does not mean that we regard your conduct as blatantly illegal or improper. Rather, it would appear that your practice was based on a good faith belief in a plausible interpretation of Section 59257(j)(6). Thus, our decision is not intended to have punitive or retroactive effect.

In the interests of constructive problem solving, I also want to suggest some possible approaches that would allow us to approve your implementing regulations. First, we would be prepared to approve implementing regulations which provided that reimbursement for the work performed by the two employees in question would be deferred for a reasonable period of time (e.g. two years). Normally we would only consider such a provision in the case of a newly formed auxiliary organization, but under the circumstances, a period for transition to the new ground rules would be appropriate. Second, the same effect could be achieved by revising the master agreement between the District and the Foundation to provide that the District will make a temporary loan to the Foundation. Finally, a more permanent solution would be to include in the master agreement between the District and the Foundation a provision spelling out benefits received by the District that equal or exceed the cost of the services performed by District employees in any given year. If you choose either of the latter two options, then you would not need to amend your presently approved implementing regulations, but we would require that you submit the revised master agreement for our review and approval in order to ensure that the Cerritos CCD will be in compliance with Section 59257(j)(6) in the future.

If you have any questions, you may call me at (916) 327-5692.

Sincerely,

Ralph Black
General Counsel

cc: Thomas Nussbaum, Chancellor
Gary Cook, Administrator, Fiscal and Business Services
Doug Cordiner, Bureau of State Audits

L 97-19

Comments

California State Auditor's Comments on the Response From the Cerritos Community College District

To provide clarity and perspective, we are commenting on the Cerritos Community College District's response to our audit report. The numbers correspond to the numbers we have placed in the response.

(1) In highlighting that our audit did not substantiate the "allegations of concerned citizens", the district mischaracterizes the scope and purpose of the audit. In fact, the audit, including the audit scope, was requested by a member of the Legislature and was approved by the Joint Legislative Audit Committee. In this audit, we reviewed many of the district's activities, including its enterprise and foundation resulting in a 39 page report containing 15 recommendations for improved operations.

(2) The district's statement overstates our audit conclusion. As stated in the Appendix, we concluded that the district complied with the applicable laws and regulations for claiming general apportionment and supplemental basic skills funding. Our audit did not confirm or verify the FTES reported for claiming general apportionment of supplemental basic skills funds. In addition, our review covered only fiscal year 1995-96.

(3) Again, the district is not totally accurate. We did not conclude that the district appropriately allocated its matriculation funds. Rather we concluded that, for the 40 expenditures we sampled, each expenditure was for a component of the approved matriculation plan and was for a permissible use.

(4) The district misstates our audit conclusion. The focus of our review was not on determining whether Title III funds were spent appropriately. Rather, our review determined that the federal government, which funds the Title III grant, was agreeable to the substitution of the district's P.E.T. project for the outreach activity described in the original grant proposal.

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(5) Once again the district is trying to deflect attention away from the significant issues contained in the body of our report. We did not "hide" the other activities we reviewed in the Appendix. In fact, we summarize the results of our review on page S-1 of our report and on page 4 direct the reader's attention to the Appendix for a more in-depth discussion regarding our review of these activities. It is illogical to conclude from our report that the college was "operationally and fiscally sound" when, in many ways, it is not.

(6) In our view, the operations of the college during the period covered by the report, particularly those of its enterprise operation, were far from "operationally and fiscally sound". For example, as we point out in Table 1, the bookstore lost $475,762 during calendar year 1996. In addition, as noted on page 5 of the report, the bookstore ineffectively manages receivables from vendors amounting to unapplied credits of $618,000 as of August 1997. Furthermore, we found the cafeteria and convenience store to potentially be nonviable without considerable subsidies.

(7) The district misses the point of our recommendation. Merely netting the bookstore's debit and credit memos against outstanding vendor invoices only addresses a bookkeeping entry that reduces its accounts receivable and accounts payable balances by a like amount. However, this action does nothing to improve the bookstore's cash flow problems. Rather than simply netting these amounts for financial statement presentation purposes, we recommend that the district actually reduce the amounts paid to book publishers by the amount of receivables due from those publishers (debit and credit memos), effectively eliminating them. In this way, vendor receivables are reduced and the bookstore's cash flow is improved. Furthermore, the district does not address the problem of outstanding cash refunds due the bookstore from vendors it no longer patronizes that can potentially be lost by inaction.

(8) In order to realize the reduction the district describes in Attachment 1, it would have had to implement our recommendation concerning reducing the amount paid to vendors by the amount of debit and credit memos for those vendors.

(9) The district is correct in that we did not identify any specific instances of a conflict of interest. However, our point is that without receiving full disclosure from all its designated employees, neither we nor the district can fully assess whether a conflict exists and the district cannot use the disclosure statements as intended.

(10) As we state in Chapter 2 of the report, using district staff to work on foundation activities is only improper when the district is not reimbursed as required by state regulations.

(11) The district is confused. We do not characterize the authority exercised by the president as inappropriate. Rather, we conclude that the bylaws of the foundation give the college president the opportunity to exert greater influence over foundation operations than presidents of other community colleges we surveyed.

(12) This claim is not supported by the information provided by the Chancellor's Office. In a letter declining approval of the Cerritos College Foundation's revised implementing regulations, the general counsel for the Chancellor's Office stated that his staff had reviewed 22 sets of district implementing regulations that the Chancellor's Office had approved and none contained a provision similar to Cerritos's that would allow the unreimbursed use of district staff to support its foundation.

(13) We disagree with the Chancellor's Office's position regarding the need for the foundation to reimburse the district for the services it provided the foundation in the past. As we recommended on page 31 of the report, the foundation needs to repay the district $171,000 for payroll costs it incurred during the two fiscal years we reviewed. Under the agreement in force during fiscal years 1994-95 and 1995-96, such payment was required. In addition, we believe that the Chancellor's Office is affording not only Cerritos, but all other community college districts, with more latitude than state regulations currently allow regarding this practice.

(14) We disagree that this was a college event. While we do not dispute that the timing of the event coincided with the college's 40th anniversary, all donations, revenues, and expenses associated with this event were accounted for exclusively by the foundation. In addition, discussion of the event was a regular agenda item in the foundation's board minutes from the time that the idea for the event was first proposed by one of the foundation's directors until the event was held.

(15) The district's assertion that it was aware of all the weaknesses we identified with the operation of the bookstore before the audit began and that it has taken steps to correct them is not entirely true. While the district was aware of some problems with its operation of the bookstore, the majority of the issues we describe in Chapter 1 of the report had never been identified by the district or its external auditors.

⑯ It is not within the scope of the California Education Code to use district employees to work on foundation activities without reimbursement to the district.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps